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H.R. 3505—FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2005

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

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H.R. 3505—FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2005

Tuesday, October 18, 2005

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 10 a.m., in Room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the subcommittee] Presiding.

Present: Representatives Bachus, Castle, Royce, Lucas, Kelly, Gillmor, Ryun, Oxley (ex officio), Biggert, Feeney, Hensarling, Brown-Waite, Pearce, Neugebauer, Maloney, Moore of Kansas, Kanjorski, Frank (ex officio), Hooley, Carson, Ford, Israel, Baca, Green, Moore of Wisconsin, Clay and Matheson.

Also present: Representative Ney.

Chairman BACHUS. Good morning. The Subcommittee on Financial Institutions and Consumer Credit is meeting today to focus on H.R. 3505, the Financial Services Regulatory Relief Act of 2005, which was authored by Congressman Hensarling and Congressman Moore in July. H.R. 3505 seeks to reduce the Regulatory Board on Insured Depository Institutions to benefit consumers and the economy by lowering costs and improving productivity. This legislation follows three earlier hearings, or this legislative hearing follows three earlier hearings on regulatory relief where we have on many occasions heard from financial institutions for the need for Congress to eliminate unnecessary regulations.

Last month we received recommendations on H.R. 3505 from regulators. Today we will hear from representatives of the financial services industry, including our panelists today, Nevada Federal Credit Union President and CEO Bradley Beal, on behalf of the National Association of Federal Credit Unions; Bank of Smithtown Chairman, President and CEO Brad E. Rock, on behalf of the American Bankers Association, and Congressman Israel is going to introduce him. We also have on behalf of the National Banking Association—I am sorry, National Bankers Association President Norma Alexander Hart; and then Superior Federal Credit Union of Lima, Ohio, CEO Phillip Buell, on behalf of the Credit Union National Association; and Independent Community Bankers of America Chairman David Hayes.

I look forward to hearing from today's witnesses and thank them for taking time from their busy schedule to join us.

Under Chairman Oxley's leadership this committee has been dedicated to freeing depository institutions from unduly burdensome regulations so that they can be more effective to meeting the credit needs of their communities. During the 108th Congress the committee produced a comprehensive regulatory relief bill that passed the House by a margin of 392 to 25. That was actually H.R. 1375. Unfortunately, the Senate took no action.

H.R. 3505 draws from and supplements the provisions of last year's bill. Additionally it includes provisions from legislation sponsored by Mr. Ryun of Kansas, H.R. 2061, the Community Banks Serving Their Communities First Act; and legislation sponsored by Mr. Royce and Mr. Kanjorski, Mr. Royce of California and Mr. Kanjorski of Pennsylvania, H.R. 2317, the Credit Union Regulatory Improvements Act, CURIA. I applaud the goals of these bills which would allow banks and credit unions to devote more resources to the business of lending to consumers and less to the bureaucratic maze of compliance with outdated and unnecessary regulations.

Let me close by commending Congressman Hensarling, Congressman Moore, Chairman Oxley, Ranking Member Frank and Ranking Member Sanders, Mr. Ryun, Mr. Royce, Mr. Kanjorski, and all other members of the committee who have worked tirelessly on this important piece of legislation. I look forward to working with them and the rest of the members of this committee as we move toward a markup and floor consideration in the coming weeks.

[The prepared statement of Hon. Spencer Bachus can be found on page 40 in the appendix.]

Chairman BACHUS. At this time I am pleased to recognize the ranking member of the full committee Mr. Frank for an opening statement.

Mr. FRANK. Thank you, Mr. Chairman. I am glad we are going ahead with this, and I think as someone who believes there is an important role for regulation in achieving important goals, that an essential part of regulation is getting regulation right. And overregulating and regulating badly undercuts the notion of the proper balance between a private and public sector operation.

For example, one of the things we will be doing is reducing some of the requirements of the Bank Secrecy Act. Instinctively people get nervous about that. They are afraid of being open to charges that we are somehow weakening our defenses. In fact, when the enforcement agencies are flooded with a lot of paper that really has nothing to do with abuses, that is what weakens law enforcement.

Gresham's law says that the bad drives out the good in currency. With regard to this sort of law enforcement, there is a modification of Gresham's law: The good can cover up the bad. The amount of paper that people have to wade through almost literally diminishes their ability to focus on those things that they should be finding. It is hard enough to find these particular needles when people are trying to cover them up; we should not be pouring more hay on, and that is what we do when we require excessive information.

So I want to reassure all my colleagues that this has been carefully worked out. And I congratulate the Department of Treasury, FINCEN, and the American Bankers Association. A number of people here did a very good job of getting together and understanding the goal, figuring out how better to accomplish it. So this is a bill

that serves the purposes of sensible regulation, and it serves as what I think ought to be the goal of this committee, which is providing an atmosphere in which the private sector, particularly those in the financial industry, can do the essential job that it has to do of providing the capital and the liquidity for the economy and at the same time protecting those legitimate public interests which have to be protected, but in a rational way.

And then finally I would note this is one more example of the ability of this committee. I think it is important to stress this. We often talk about how bipartisan we are. I think it is important for this committee and every other arm of the Congress to be both bipartisan and partisan sometimes in the same week. That is, there are legitimate differences between the parties. There are legitimate issues that we ought to have debate about. What this committee shows, I think, is that you can have those debates on those issues which divide us without that poisoning the atmosphere, so that when we come together on things like this where there are really technical issues and not ideological ones that we ought to be able to work together, we are able to do that. And, Mr. Chairman, I would say to the chairman of the subcommittee that you deserve a great deal of the credit for creating that kind of atmosphere.

So I look forward to our not just having this hearing, but marking up a bill and, I would hope, passing this as soon as possible. Certainly there is no reason why we shouldn't be passing it here before the end of the year. And as to the Senate, we will see what happens. But the sooner we send them something, the likelier we are to see some positive action.

Thank you, Mr. Chairman

Chairman BACHUS. Thank you, Mr. Frank. And I very much appreciate those remarks and appreciate working with you on this legislation.

I now recognize one of the sponsors of this legislation, the principal sponsor along with Mr. Moore, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman. And first let me again thank you for your leadership in doggedly pursuing this issue. Even though he is not here, I want to thank Chairman Oxley for his leadership as well, and to follow up on the ranking member's comments in creating a place in Congress where one can truly work in a bipartisan fashion. I want to thank Ranking Member Frank for his contributions to this. And as a former student of economics, I especially appreciate anybody who can properly cite Gresham's law. So that impresses me as well.

I want to thank Mr. Moore, my colleague from Kansas, for his contributions and working closely together with him on this bipartisan piece of legislation and my colleague Mr. Ryun of Kansas for his leadership in the Communities First Act, a number of provisions which were included in this act, as you well know, Mr. Chairman, and as you have cited.

Clearly the time for some regulatory relief is upon us. We all know that many regulations, although well intended, have costs associated with them. Many of these costs end up being imposed ultimately upon consumers. Many regulations are duplicative. Many have unintended consequences. Sometimes I think we excel at un-

intended consequences in Congress. Some outlive their purposes, and some never achieve their purposes in the first place.

At the end of the day, these excessive regulations can make credit less affordable and less accessible to people in our society who need it the most. They can prevent somebody from buying their first home, buying an automobile they need to commute to work, or maybe even capitalizing a small business and creating new jobs. They can also hurt consumers in another way, and that is they can drive out competition. They create fewer choices for the consumer in the financial services marketplace.

We have heard testimony earlier that in the last decade community banks, which I think are vital to the economic lifeblood of rural America, have contracted from roughly 13,000 to roughly 8,000. One of the reasons this is happening is because of a disproportionate regulatory burden. As we know, our banks have had to contend with approximately 850 new regulations since 1989. They cannot keep up with this particular burden.

If we want to help the economic development of rural America, if we want to help our inner cities, if we want to help our consumers, we do have to have some regulatory relief. I believe that H.R. 3505 goes a long way in achieving that. It makes great strides. It doesn't include every provision I would like, but I think we have done a good job in achieving significant consensus within this committee, and I think that we strike a good balance on a number of issues, and that we will hopefully at the end of the day see this actually become the law of the land.

Thank you, Mr. Chairman, and I yield back.

Chairman BACHUS. Thank you, Mr. Hensarling.

Mrs. Maloney.

Mrs. MALONEY. Thank you, Chairman Bachus and Ranking Member Frank. And I welcome all of the witnesses, particularly Mr. Rock from the great State of New York. We are glad you are here, and we look forward to hearing all of your testimony.

As a Representative from New York, the financial center of the United States, I am particularly concerned about the burdens that regulations and reporting requirements impose on our financial institutions, particularly those that are not megainstitutions, but are midsize and smaller. And I know that the vast majority of my colleagues feel the same way. That is why we have come forward with basically a bipartisan consensus on this bill. We had it last year when we passed reg relief overwhelmingly. It died in the Senate. But this bill before us is an improved version and addresses areas of special concern to me.

I applaud the leadership of Congressman Frank in working out an agreement for the ILCs, and I must say that wherever I go in my district, smaller institutions tell me how hard and costly it is to comply with the requirements of the BSA Act to file the CTRs, the SARs. They say the burden, the paperwork, is just overwhelming, and it is particularly hard on smaller institutions where the costs of compliance are a much higher proportion of their resources. And this bill includes a new section that addresses these concerns. It is not perfect, but it is a step in the right direction.

And I look forward to continuing to work with Chairman Bachus, FINCEN, and others to further refine the exemption process that

we require in a new section 701 that FINCEN and law enforcement finds viable and that will help in their oversight, too. I think that this is a critical part of the bill.

Also, this bill contains the Credit Union Regulatory Improvement Act, which I have supported in several Congresses, and these provisions offer relief to credit unions. And I hope that we will be able to move forward in this bill and finally pass the remaining portions of CURIA, especially the reforms to the prompt corrective action system and the conversion provisions. I believe that these additional reforms will bring valuable certainty to the credit union sector of the market.

So I thank everyone for coming, and I look forward to your testimony and hopefully passage of the bill.

Thank you. I yield back

Chairman BACHUS. Thank you.

I am told that no other members of the—Mr. Chairman. Chairman Oxley. I am sorry.

Mr. OXLEY. Thank you, Mr. Chairman. I want to thank you for holding this hearing on H.R. 3505. I sneaked in on you, Mr. Chairman. Your peripheral vision is not what it used to be.

Chairman BACHUS. I knew you were here. They just didn't tell me you wanted to speak.

Mr. OXLEY. I want to thank you for holding this hearing on the Financial Services Reg Relief Act of 2005 and look forward to hearing from the financial services industry trade groups with their views on H.R. 3505 and how this bill provides much-needed relief from outdated, unnecessary regulations.

The case for giving banks, credit unions, and other financial institutions regulatory relief has never been stronger. This Congress we have held three hearings on this important subject. The FDIC has testified that since 1989, Federal regulators have issued over 800 separate regulations affecting financial institutions, requiring significant adjustments to existing systems and other costly steps to ensure compliance. And while no one is suggesting that these regulations are not well intentioned, the sheer volume of mandates emanating from Washington makes it incumbent upon those of us in the Congress to find ways to ease regulatory burdens where we can so that the financial services industry can focus more of their finite resources on serving customers rather than contending with bureaucratic red tape.

This year the legislation has been introduced by two well-respected members of our committee, Mr. Hensarling and Mr. Moore, which builds on the provisions in the regulatory relief bill that won overwhelming approval in the House last year, but was never taken up in the Senate. H.R. 3505 includes virtually all of the provisions of last Congress's reg relief bill, a new title that addresses Bank Secrecy Act issues, and over 20 new provisions. And I want to thank both the gentleman from Kansas and the gentleman from Texas for their leadership on this issue.

I want to thank the witnesses for appearing here today, particularly Phil Buell from Lima, who represents the—who is president/CEO of Superior Federal Credit Union in Lima, Ohio, in the Fourth Congressional District. Other than the fact that he went to 2 MAC schools that were not Miami, he is a fine, upstanding cit-

izen and a good representative of the credit union industry. I look forward to their comments on the bill.

We can achieve regulatory relief for deposit institutions so they can better serve their customers and their communities. And, Mr. Chairman, let me again salute your leadership on this issue. This is now a time to punch it across the goal line, and I think if we—I suspect we will get a good, strong bipartisan vote in the committee when we mark this legislation up, and then also on the floor, to get a good head of steam over in the other body. I know that Senator Crapo, among others, has expressed an interest, and we have already had a hearing, which is progress certainly on that side of Capitol, and we are hopeful that this session of the Congress we can come to fruition and get this bill passed and signed by the President.

The pressures are enormous on the financial institutions. We have asked them to do an awful lot with the PATRIOT Act, with the Bank Secrecy Act, all of those regulations, the 800 and some regulations coming down from above. It is clearly a time for regulatory relief. And again, now is the time to get it done. And I yield back

Chairman BACHUS. I thank the Chairman.

And my eyesight is not as good as my leadership, I guess, right? But I had an opening statement, and I went on and on about your leadership. And Mr. Frank also complimented you.

At this time we will hear from Mr. Moore who obviously with Mr. Hensarling, as we have all heard, introduced this legislation and played a key role in it.

Mr. MOORE OF KANSAS. I would like to thank my friend Chairman Bachus for sponsoring the hearing today, convening this hearing. I would also like to thank Chairman Oxley for his leadership in this area. You have been very strong, and I really appreciate that. And, Chairman Bachus, thanks for scheduling today's hearing on regulatory relief legislation, H.R. 3505, which was introduced by Congressman Hensarling and myself and cosponsored by 32 members of this committee on both sides of the aisle. And that is one of the gratifying things to me about this committee is the bipartisanship which we on many, many occasions are able to achieve that sometimes other committees in Congress don't get, and I really, really appreciate that. The Financial Services Committee has a strong record of bipartisanship, and I am glad it has extended to this bill. Regulatory relief should not be about Republicans or Democrats. It should be about doing the right thing for the lenders in our communities who have played such an important role in expanding home ownership and for creating opportunities for businesses and consumers.

Small lenders in our communities particularly feel the burden of unnecessary regulations. Whenever Congress or the regulatory agencies impose a new burden on industry, small institutions must devote a large percentage of their staffs' time to review the new law or regulation, determine if and how it will affect them. Compliance with new laws and regulations, while sometimes necessary, nearly always takes a large amount of time that businesses cannot devote to serving their customers and our constituents.

Strong regulation of our country's financial system is absolutely essential, but Congress and the financial regulators have a responsibility to strike the right balance in this area, and 3550 is an important step in the right direction, I believe.

Since coming to Congress, and particularly over the last few months, I have heard from many depository institutions in my district and throughout Kansas, and I have tried to address in 3505 some of the concerns that I have heard. While assets for State-chartered banks in Kansas have reached an all-time high of $27 billion, our communities' banks are also struggling to comply with both old and new reg burdens, including some created under the Bank Secrecy Act.

3505 seeks to provide relief from some of these new burdens to our financial institutions in a way that preserves our ability to track terrorist financing and build upon our success in freezing the funds of terrorists. Representative Hensarling and I and the bill's bipartisan cosponsors agree that waging a strong war on terror and providing some reg relief to our financial institutions are not incompatible goals.

Additionally, 3505 provides two new sections of reg relief for our credit unions that were not included in the previous version of this measure, 1375. This subcommittee and the full committee both passed the reg relief bill by voice vote during the 108th Congress, and the House passed it 1 year ago by a wide margin, 392 to 25.

I look forward to continuing the broad bipartisan cooperation on this legislation that we have enjoyed in the past. Again, thank you, Chairman Bachus, and I look forward to hearing from the witnesses.

Chairman BACHUS. Thank you.

At this time are there any other opening statements that members would like to make?

Without objection, the gentleman from Ohio, Mr. Ney, will be permitted to participate in today's hearing. Although he is not a member of the subcommittee, he is chairman of the housing subcommittee, and we welcome you.

Mr. NEY. Thank you, Mr. Chairman. I don't—I would just like permission to enter my statement for the record without reading it, with one amended part; that Mr. Oxley is a great Ohio leader.

[The prepared statement of Hon. Robert W. Ney can be found on page 44 in the appendix.]

Chairman BACHUS. And without objection, opening statements of all members will be introduced in the record. And I know Mr. Baca and other members have opening statements that they wish to submit.

I would like to introduce our panel now. Mr. Brad Beal is president/CEO of the Nevada Federal Credit Union, which is the largest credit union in the State of Nevada with 82,000 members. He, prior to that, was at other credit unions, both in Nevada and Utah. And, Ms. Biggert, he is a native of Illinois and is proud of that fact and graduated summa cum laude from Bradley University in Peoria, Illinois. He is also a certified public accountant and a member of the American Institute of Certified Public Accountants.

Our next panelist, Mr. Israel, I am going to recognize you for an introduction of.

Mr. ISRAEL. Thank you, Mr. Chairman. Thank you for giving me the privilege of introducing Brad Rock, who has been a key advisor and a good friend on Long Island. And I should say, Mr. Chairman, parenthetically that one of the sponsors of this resolution, Mr. Moore, happened to have been on Long Island last weekend, visited Smithtown as guests of my wife and myself.

Mr. Rock has served as chairman of the board, president and chief executive officer of the Bank of Smithtown and its public holding company, Smithtown Bankcorp, for the past 16 years. The Bank of Smithtown is a 96-year-old community bank on Long Island with assets of approximately $750 million. He currently serves as chairman of the ABA Government Relations Council. He has previously testified before the House Financial Institutions Subcommittee, the Senate Banking Committee, and he is also a former president of the Independent Bankers Association of New York State.

And, Mr. Chairman, I know we all have constituents like Mr. Rock who are so tenacious, so persistent, and so diligent, they don't even take yes for an answer. They just keep asking and asking. And I am pleased to introduce Mr. Rock.

Chairman BACHUS. It is my pleasure to introduce Norma Alexander Hart. Ms. Hart has been the president of the National Bankers Association since 1997. And actually you were first with the National Banking Association back in the early 1980s, before she left to work at United National Bank in Washington, D.C., which was a minority-owned bank which later merged with Madison National Bank, and she served as a marketing officer and rose to the position of assistant vice president. She received her B.A. from the University of the District of Columbia. She resides in Washington, D.C., with her husband, attorney Tom Hart, and you all have three children. And you don't have a plane to catch after this hearing? And we welcome you. She has an extensive resume. And we welcome you and look forward to your testimony. I think this is the first time you have testified before this committee; is that correct? That is correct. So we welcome you, Ms. Hart.

Mr. Phillip Buell is our next panelist, who is representing CUNA, Credit Union National Association. Chairman Oxley has previously introduced Mr. Buell. We welcome you. It seems like we always have an Ohio representative on our panel, and we welcome you.

Our last panelist is David Hayes. David, you have testified before the committee on four or five previous occasions as a representative of the independent community banks, and we welcome you back before the hearing.

He is president/CEO of Security Bank of Dyersburg, Tennessee. As we have said before, he is very active in serving as chairman of the board back in Dyersburg of the United Way and the Heart Association and various other civic boards. And we appreciate your testimony. He is wearing a Tennessee Vols tie, not realizing that I represent the University of Alabama, and that this weekend the University of Tennessee and the University of Alabama meet in Tuscaloosa. And it is probably good that he has got that tie on this week instead of next week. But, no, we have joked about that.

So we welcome all our panelists this morning. And at this time, without objection—we have already done that. At this time I am going to recognize Mr. Beal for your opening statement.

STATEMENT OF BRADLEY W. BEAL, PRESIDENT/CEO, NEVADA FEDERAL CREDIT UNION, REPRESENTING NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

Mr. BEAL. Thank you, Mr. Chairman. And good morning, Mr. Chairman, Ranking Member Sanders and members of the subcommittee. My name is Brad Beal, and I am the president and CEO of Nevada Federal Credit Union, which is located in Las Vegas, Nevada. I am here today on behalf of the National Association of Federal Credit Unions to express our views on H.R. 3505. As with all credit unions, Nevada Federal is a not-for-profit financial cooperative governed by a volunteer board of directors who are elected by our member-owners.

I am pleased to report to you today that America's credit unions are vibrant and healthy and that membership in credit unions continues to grow, now serving over 87 million Americans. At the same time, according to data obtained from the Federal Reserve, credit unions have the same market share today in terms of financial assets as they did back in 1980, that being 1.4 percent, and as a consequence provide little competitive threat to other financial institutions.

NAFCU would like to thank Representatives Hensarling and Moore for their leadership in introducing H.R. 3505. We support the credit union provisions included in title 3 of that bill. We believe these provisions are a positive step in addressing many of the regulatory burdens and restrictions on Federal credit unions.

The facts confirm that credit unions are more heavily regulated than other consumer financial services providers. Furthermore, NAFCU is pleased to see the efforts of title 7 to help reduce the Bank Secrecy Act compliance burden on many financial institutions.

While we believe H.R. 3505 is a solid bill as introduced, we believe that it can be made stronger by including much-needed additional provisions from the Credit Union Regulatory Improvements Act, also known as CURIA. I would like to thank Congressmen Royce and Kanjorski for taking the lead in introducing this vital legislation that has received bipartisan support of about 100 cosponsors.

NAFCU urges the subcommittee to add language to H.R. 3505 to modernize credit union capital requirements by redefining the net worth ratio to include risk assets as proposed by the NCUA and included in Title I of the CURIA bill. This would result in a new, more appropriate measurement to determine the relative risk of a credit union's balance sheet and also improve the safety and soundness of credit unions and our Share Insurance Fund. I would like to point out that the current capital system treats a 1 year unsecured $10,000 loan the same as a 30-year mortgage that is on its last year of repayment. This simply does not make sense.

We are moving from a model where one size fits all to a model that considers the degree of risk in each credit union's balance sheet. This proposal advocates a reduction in the standard net

worth or leverage ratio requirements for credit unions to a level comparable to, but still greater than, what is required of FDIC-insured institutions. Further strength is gained because this proposal advocates a system involving complementary leverage and risk-based standards working in tandem.

NAFCU also asks the subcommittee to refine the Member Business Loan cap established as part of the Credit Union Membership Access Act back in 1998, replacing the current formula with a flat rate of 20 percent of the total assets of a credit union. We support revising the definition of a member business loan by giving NCUA authority to exclude loans of 100,000 or less from counting against the cap. There is a lot of rhetoric about this issue out there, but I note that a 2001 Treasury Department study entitled Credit Union Member Business Lending concluded that, quote, credit unions' business lending currently has no effect on the viability and profitability of other insured depository institutions, close quote.

In conclusion, the state of the credit union community is strong, and the safety and soundness of credit unions is unquestionable. Nevertheless, there is a clear need to ease the regulatory burden on credit unions as we move forward in the 21st century financial services marketplace. NAFCU supports H.R. 3505, but believes it can be made even stronger by adding amendments to modernize credit union capital requirements and refine the arbitrary credit union member business lending cap. We look forward to working with you on these important matters, and we would welcome your comments or questions.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Beal.

[The prepared statement of Bradley W. Beal can be found on page 45 in the appendix.]

Chairman BACHUS. And all panelists, your written statements will be made a part of the record, and of course we are—you are just giving a 5-minute opening statement. And appreciate, Mr. Beal.

Mr. Rock, you are recognized.

STATEMENT OF BRADLEY E. ROCK, CHAIRMAN, PRESIDENT, AND CEO, BANK OF SMITHTOWN (NEW YORK), REPRESENTING AMERICAN BANKERS ASSOCIATION

Mr. ROCK. Thank you, Mr. Chairman.

I am chairman, president, and CEO of Bank of Smithtown, an $800 million community bank located in Smithtown, New York, founded in 1910. I am also the vice chairman of the American Bankers Association.

Competitive inequities and the cost of unnecessary regulation is a serious long-term problem that continues to erode the ability of banks to serve our customers and support the economic growth of our communities. We applaud the efforts of the committee to reduce the regulatory burden on banks and to restore balance to the regulatory process.

I have included a list of recommended actions with my written testimony, each one of which would provide much-needed regulatory relief to my bank and others like mine, but today there are three especially timely issues that I would like to emphasize.

First, ABA believes that the current CTR standards have outlived their utility in detecting criminal activity. Maintaining the CTR threshold at the current level generates too many reports with immaterial activity and wastes banker and law enforcement time. This time could be better spent on suspicious activity report detection and investigation. The solution is to eliminate the CTR requirements for seasoned customers with transaction accounts. At a recent hearing before this committee, Financial Crimes Enforcement Network Director William Fox and other chief regulators supported this idea. The time has come to enact this reform.

Second, I understand that there may be efforts to incorporate provisions of H.R. 2317, the Credit Union Regulatory Improvements Act, with the regulatory relief legislation pending before this committee. We urge the committee to reject H.R. 2317 and not incorporate its provisions into a larger regulatory relief package. H.R. 2317 would greatly expand credit union commercial lending authority while at the same time undercut the regulation of capital levels at federally insured credit unions. These changes would fuel even more rapid expansion of a segment of the credit union industry that openly flaunts its congressionally mandated mission to serve people of modest means.

Today more than 100 credit unions surpass $1 billion in assets and use their tax exemption to compete head to head with taxpaying banks. These conglomerate credit unions are much larger than the typical community banks in their local market, which have an average asset size of approximately $100 million. The current tax-exempt status of these diversified conglomerate credit unions and lack of equivalent regulation has created huge competitive inequities in the local marketplace and represents an ever-increasing abuse of the credit union tax subsidies. H.R. 2317 would exacerbate these competitive inequities as well as raise safety and soundness concerns.

Third, Wal-Mart's recent application for an industrial loan corporation charter and Federal deposit insurance has triggered renewed interest in commercially owned ILCs. ABA has long taken the position that commercial firms should not own banks or savings institutions because of the potential of conflicts of interest, particularly in the credit-granting process, and because of the potential for an unhealthy concentration of economic power.

The ILC charter remains an open avenue for commercial firms, even those large firms that are not primarily financial in nature, to provide retail and corporate banking services. Therefore, ABA supports language in the regulatory relief bill to deny new commercially owned ILCs de novo branching authority and look forward to working with the committee on the broader issue of commercially owned ILCs. Thank you, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Rock.

[The prepared statement of Bradley E. Rock can be found on page 120 in the appendix.]

Chairman BACHUS. Ms. Hart.

STATEMENT OF NORMA ALEXANDER HART, PRESIDENT, NATIONAL BANKERS ASSOCIATION

Ms. HART. Thank you, Chairman Bachus.

Good morning, Chairman Bachus, Ranking Member Sanders, and other distinguished members of the Subcommittee on Financial Institutions and Consumer Credit. My name is Norma Alexander Hart. I am president of the National Bankers Association. It is my pleasure to provide comments on behalf of the Association regarding H.R. 3505, the Financial Services Regulatory Relief Act of 2005, pending Congress.

For nearly 80 years the NBA has served as the trade association advocating for minority- and women-owned financial institutions. Moreover, the NBA and its 50 member banks and 30 associate members has worked with the Federal Government to develop policies, regulations, and laws that recognize the importance of preserving and fostering minority-owned and -controlled banking institutions.

Regulatory relief has been around for years. First let me commend the committee for its hard work on this issue. We have been supporting this effort for a number of years on the Hill. The NBA is pleased to support the overall thrust of the regulatory relief bill. There are many regulations that need to be updated or in some cases eliminated to make the banking industry more competitive and available to the American public, to many lower-income Americans that are still unbanked, and we hope that this bill will make it easier for financial institutions to offer services to this important segment of our population.

The purpose of the act is to update regs and to lift the regulatory burden on banks. The regulations imposed by the regulators often disproportionately burden the minority- and women-owned banks. Efforts should be made to streamline compliance of regulations that are intrusive and costly to banks with deposits of 3 million or less; for example, Sarbanes-Oxley internal controls, IT compliance, Bank Secrecy Act, privacy issues, and PATRIOT Act reporting. Each of the above regulations impose a high cost of compliance. These costs impose a severe burden on small, minority-owned institutions.

Three, de novo banks. Specifically we note our concern about the provisions of the act that open the financial services industry to enterprises and industries that would use banking and mortgage lending as an ancillary service to their primary business. The NBA does not believe financial services should be provided as a commodity at over-the-counter stores or fast-food restaurants. Consumers should not go mortgage shopping at the same time they go food shopping. This will undermine the safety and soundness of the banking industry in America.

The NBA is concerned about nontraditional ownership of financial institutions. Regulators must take a fresh look at this issue. The act should impose separation between the retail and banking services. Restrictions on locations and cross-marketing efforts should be imposed. If retail chains are invited into the banking industry, they should be available to offer only limited services, and their roll-out should be staggered. The committee should not open the doors too widely.

Four, preservation of minority banks by section 308 of FIRREA. Pursuant to sections 301 and 308 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, FIRREA, Congress

has mandated that the FDIC and the OTS conduct activities that recognize and preserve the special and unique status of minority-owned financial institutions.

Over the years this legislation has lost much of its relevance and impact. As a result, the number of minority- and women-owned banks is decreasing. This regulation should expand to include other regulatory bodies, and the regulators should be instructed to undertake deliberate efforts to foster the number and competitiveness of minority institutions. Additionally, regulators should provide minority banks the first opportunity to acquire troubled institutions or other banks or savings institutions that are being divested.

Conclusion. The NBA suggests that this historic legislation be modified to ensure the continued vitality of minority- and women-owned banks in America. We look forward to working with the subcommittee and its staff to accomplish this goal.

We thank you for this opportunity to testify, and I am available for questions and comments from the distinguished panel. Thank you.

Chairman BACHUS. Thank you, Ms. Hart.

[The prepared statement of Norma Alexander Hart can be found on page 89 in the appendix.]

Chairman BACHUS. And now we will hear from Mr. Buell.

STATEMENT OF PHILLIP R. BUELL, PRESIDENT/CEO, SUPERIOR FEDERAL CREDIT UNION, LIMA, OHIO, REPRESENTING CREDIT UNION NATIONAL ASSOCIATION

Mr. BUELL. Thank you, Mr. Chairman.

Chairman Bachus, members of the subcommittee, on behalf of the Credit Union National Association, I appreciate this opportunity to express the Association's views on H.R. 3505, the financial services regulatory relief act. This bill can be an important step to help alleviate the regulatory burden under which all financial institutions operate today. Instead of responding to the ABA's misinformation campaign, we will devote our remarks to ways in which we can better serve our members and America's consumers. I am Phil Buell, president and CEO of Superior Federal Credit Union in Lima, Ohio.

According to the U.S. Treasury, credit unions are clearly distinguishable from other depository institutions in their structure and operational characteristics and have more limited powers than national banks and Federal savings associations. Given the limited time available, I will devote my statements to describing a few exceptionally important items for credit unions. Many of these are addressed in the recently introduced H.R. 2317, the Credit Union Regulatory Improvements Act, or CURIA, while some are incorporated in H.R. 3505.

As part of our mission, credit unions are devoted to providing affordable services to all of our members, including those of modest means. One provision that this committee and the House have already passed would better enable us to meet that goal. I am referring to H.R. 749, legislation to permit credit unions to provide broader check-cashing and remittance services.

Accomplishing our mission can also be greatly enhanced by revisiting two major components of the 1998-passed Credit Union Mem-

bership Access Act. With 7 years of experience, we have learned that what was thought to be good policy has actually new problems that need to be resolved to assure that credit unions can continue to meet their mission.

The first of these issues is the current cap on member business lending. There was no safety and soundness to impose these limits, as the historical record is clear that such loans are even safer than other types of credit union loans. In fact, public policy argues strongly in favor of eliminating or increasing the limits from the current 12.25 percent to the 20 percent suggested in CURIA.

Small business is the backbone of our economy and responsible for the vast majority of new jobs in America, Yet recent SBA and Federal Reserve Bank of Atlanta studies reveal that small businesses are having greater difficulty in getting loans in areas where bank consolidation has taken hold. The 1998-passed law severely restricts small business access to credit and impedes economic growth in America. This is especially important today as we all try to help to rebuild the devastated Gulf Coast where many have lost their jobs and need even more access to capital.

Although few credit unions are currently bumping up against the cap, in a few years this is likely to change. For example, my credit union just started its full-service business lending program this year and has currently lent out 5.5 percent of our assets. We project we will hit the 12.25 percent cap within the next 24 months.

The situation is even tougher for small credit unions. Investing in expertise needed to run a member business lending operation is a very expensive proposition. With a 12.25 percent cap, they cannot make up the cost needed to run such an operation.

Furthermore, the NCUA should be given the authority to increase the current $50,000 threshold as proposed in CURIA to $100,000. This would be especially helpful to small credit unions as they would then be able to provide the smallest of these loans without the expense of setting up a formal program.

Another critical issue addressed in CURIA is the prompt corrective action regulations governing credit unions. Credit unions have higher statutory capital requirements than banks, but credit unions' cooperative structure creates a systemic incentive against excessive risk taking, so they may actually require less capital to meet potential losses than do other depository institutions. And because of their conservative management style, credit unions generally seek to be always pacified as well rather than adequately capitalized. To do that they must maintain a significant cushion above the 7 percent level. For example, my credit union consistently maintains capital levels between 11 and 12 percent. Such high capital levels prevent us from providing our members with the best possible service.

CUNA believes that the best way to reform PCA would be to transform the system into one that is much more explicitly based on risk measurement as outlined in CURIA. It would place more and greater emphasis on ensuring there is adequate net worth in relation to the risk a particular credit union undertakes. At the same time, CUNA believes credit union PCAs should incorporate a

meaningful leverage requirement comparable to that in effect for other federally insured institutions.

CUNA strongly supports CURIA's new rigorous safety and soundness regulatory framework for credit unions, which is anchored by meaningful net worth requirements which are comparable to or stronger than bank PCA. And credit unions agree that any credit union with net worth ratios well below those required to be adequately capitalized should be subject to prompt and stringent corrective action. There is no desire to shield such credit unions from PCA. They are indeed the appropriate targets of PCA.

Because of the cooperative funding structure of the National Credit Union Share Insurance Fund, credit unions are keenly aware that it is they who pay when a credit union fails. Reforming PCA along these lines would preserve and strengthen a fund that would more closely tie a credit union's net worth requirements to its exposure to risk. It would also free up more capital for making loans to members and putting more resources back into our economy.

Finally, we thank you, Chairman Bachus and others, for introducing and moving H.R. 1042 to address the pending issue before FASB that would cause undue hardship to credit unions by forcing them to change from the pooling method of accounting and for including it in H.R. 3550.

In summary, Mr. Chairman, we strongly urge the subcommittee to act on this very important issue this year and to make sure that CURIA is a part of any congressional action to provide financial institutions regulatory relief. CURIA is our future. Without CURIA, millions of Americans will be deprived of a credit union able to respond to their needs. Thank you, Mr. Chairman

Chairman BACHUS. I thank you.

[The prepared statement of Phillip R. Buell can be found on page 64 in the appendix.]

Chairman BACHUS. Mr. Hayes.

STATEMENT OF DAVID HAYES, CHAIRMAN, INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. HAYES. Mr. Chairman and members of the subcommittee, again, my name is David Hayes, and I am chairman of the Independent Community Bankers of America and the chief executive officer and president of Security Bank, a $135 million community bank located in Dyersburg, Tennessee, 85 miles north of Memphis in rural west Tennessee.

I am pleased to testify on H.R. 3505, the Financial Services Regulatory Relief Act of 2005, introduced by Representatives Jeb Hensarling and Dennis Moore.

ICBA representatives have testified many times before this committee. Reducing regulatory burden remains a top concern and focus of community banks. We strongly endorse the Hensarling-Moore initiative. It demonstrates their understanding of benefits of regulatory burden relief for communities that they represent.

ICBA especially appreciates the fact that the bill includes five provisions from Representative Jim Ryun's Communities First Act, H.R. 2061, that are of particular interest to community banks. By lifting the yoke of regulatory burden from our banks, the Commu-

nities First Act would allow community banks to focus our resources on serving our communities and customers more fully.

CFA has gained tremendous bipartisan support in the House with 75 sponsors and was introduced in the Senate as S. 1568 with three sponsors. A total of 44 State banking associations have endorsed CFA. H.R. 3505's CFA provisions would direct the agency to streamline call reports, permit communities banks to file short form call reports, expand the eligibility for the 18-month exam cycle to banks with up to 1 billion in assets, expand the eligibility of bank holding companies for simplified reporting to 1 billion in assets, and exempt banks from having to send out annual privacy notices if they do not generally share information and have not changed their policies.

We urge the committee to consider adding the following provisions to H.R. 3505. Require Federal regulatory agencies to consider the effect of regulations on community banks, relax the Truth in Lending Act 3-day right of rescission in certain cases to give consumers quicker access to their funds. Update limits on loans to officers and directors to account for inflation. Update the limits on management interlocks to make it easier for community banks to attract qualified directors.

H.R. 3505 also includes the ICBA-backed Gillmor-Frank language to limit the branching authority of industrial loan companies acquired or formed by commercial firms. The fact that Wal-Mart, the Nation's largest and most aggressive retailer, has applied for what is an essentially a State banking charter highlights the urgency of this issue. This language would prohibit predominantly commercial firms from buying or establishing an ILC and using the new branching authority to establish a nationwide branching network.

A recent GAO report found that the IOC parent companies are not adequately regulated and posed increased risk to the deposit insurance fund. Even though the FDIC examines and supervises ILCs, it is said it has less extensive authority to supervise ILC holding companies than the consolidated supervisors of bank and thrift holding companies. It continues that ILCs may pose more risk of loss to the bank insurance fund than any another insured depository institutions operating in a holding company. GAO has called on Congress to close this regulatory gap.

In our testimony earlier this year, we emphasized that unlike the Communities First Act, the credit union bill, H.R. 2317, goes far beyond regulatory relief. The credit union bill is a powers enhancement proposal. While the Communities First Act includes no powers, no new powers, for anyone, ICBA strongly opposes new powers for credit unions so long as they have an unfair tax and regulatory advantage over community banks.

There is one area where we believe credit unions very much need regulatory relief. Earlier this year the NCUA attempted to undermine two Texas credit unions' ability to convert to a mutual thrift charter. ICBA strongly supports Representative McHenry's bill, H.R. 3206, that would eliminate NCUA's ability to micromanage the conversion process.

We also urge the Congress to act quickly on legislation to provide relief to communities and community banks affected by the hurri-

canes along the Gulf Coast. I have highlighted that legislation in my written statement.

ICBA very much appreciates this opportunity to again testify on the importance of regulatory relief to provide bankers with more time and energy to grow their hometowns. Thank you, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Hayes.

[The prepared statement of David Hayes can be found on page 92 in the appendix.]

Chairman BACHUS. And I thank all our witnesses today for their testimony.

Mr. Israel and I, before the hearing were talking about that these reg relief hearings kind of are like Ground Hog Day because we have had so many of them. But I will say that the statements today sort of disprove that because we did hear some sort of new and more forceful testimony. I was actually glad that the ABA—ABA testimony sometimes is dry and sometimes mundane, and I notice today it was very exciting and upbeat.

Mr. ROCK. Thank you, Mr. Chairman.

Chairman BACHUS. So that was quite different from sometimes. It obviously took positions on issues. So I don't know that I would say I commend you for that, but obviously I will just note that.

I want to say that this effort, which I think is a very good bill—I think it is a wonderful bill that we have before us. As Mr. Hayes went down some of the people that have endorsed the bill, and I want to recognize John Butler, who is at my side, for his contributions along with Peter Barrett, who is behind me here; Emily Pfeiffer, who Mr. Castle has trained well and has worked very hard on this legislation, as well as Joe Pinder on our side. And I am sure that Chairman Frank would—I know that Ken Swab has worked very hard on the legislation. I would like to recognize you, Ken, and I know that your staff has worked very closely with our staff, and I think it has been a model of how we would work.

There has been—I will say that some of your suggestions even today I think are good suggestions. Some of what you have suggested we will address in this bill, some of the things that there is a building consensus that we need to address. We work with the regulators and law enforcement.

One thing that I am very optimistic on in working with and talking with Members of the Senate and Mr. Hensarling and Mr. Moore is our CTR provision, which I think is coming together very well. And I think we will have some probably minor tweaks to frequency and portability, and once we address those, we will—and I think maybe the major thing that we are going to revise is this thing about portability, which I think is problematic.

Chairman BACHUS. I think we will come out with actually a better provision after the manager's amendment that will build a real consensus with our colleagues in the Senate and law enforcement. And I will continue to work with the ABA and with the other associations as we do that.

And at this time I am going to yield the balance of my time to Ms. Biggert, who has worked very hard on this issue. She is actually going to chair the hearing in my absence. And I think it is very appropriate that she do this. She is a very knowledgeable member

of our committee. And I would have asked Mr. Ryan or Mr. Hensarling or someone else to chair the hearing, but because many other members have provisions in the bill, I think it is appropriate that Ms. Biggert chair the committee—either she or Mr. Lucas—so at this time I recognize her.

Well, I will let you stay there.

Mrs. BIGGERT. [Presiding.] Thank you, Mr. Chairman.

First of all, I would like to welcome all of the panelists and thank you for your testimony.

Ms. Hart, you highlight your concern about the large retail operations entering the banking business. Could you expand a little bit on your concerns?

Ms. HART. Well, there has been some concern about companies such as Wal-Mart—not that we are against them because they are putting banks in their stores—but since our banks are so small, we are concerned, you know, we don't want to lose any banks, so that is our concern. Competition would be pretty strong.

Mrs. BIGGERT. Are you aware that there is language, including that which has been authored by Representative Gillmor and Ranking Member Frank, that sets an 85 percent threshold of an institution's revenues must be generated from financial interests?

Ms. HART. Yes.

Mrs. BIGGERT. Would that alleviate your concerns?

Ms. HART. We would like to see it happen. We are just not sure at this time. I need to see a little more regarding it. I have met with some of the people from Wal-Mart and they assure us that they want to work with some of our banks.

Mrs. BIGGERT. Thank you.

Mr. Hayes, you talked about this too, and I think you have got in your testimony quite a bit of materials about Wal-Mart. Could you address that issue?

Mr. HAYES. Yes, ma'am.

We certainly think the Gillmor-Frank amendment is a start. I think if Wal-Mart or any other commercial entity had to operate under the supervisory rules of the Federal Reserve and the Bank Holding Company Act, I think that puts the same muster in the operation that we have for community banks. You know, I've seen what a Wal-Mart does to communities. I have seen the empty stores. I have seen Joe's Hardware Store go out of business. I have seen a local retailer have to go to Wal-Mart to purchase the soft drinks to sell in their store. They are a monopoly. They control the market.

And I think that credit and investment issues in our communities, if we don't wrap that tight, we will live to regret the day that they have that authority to control the credit needs of the consumers in our markets. I am very passionate about it. I live in a small community. We have a Wal-Mart. I go there. I don't like to go there, but unfortunately it has run out those core mom-and-pop entities that we all know have built this great country. We have got to put the teeth into law to control that movement into this business segment.

Mrs. BIGGERT. Do you think that that 85 percent threshold would have any effect on what they could do?

Mr. HAYES. Oh, there are always some things that will have some effect, but I am very passionate that we have got to take this all the way to the wall.

Mrs. BIGGERT. Thank you.

Mr. Rock, would you care to comment on that?

Mr. ROCK. Well, we support the proposal that is currently in the bill that would prevent commercially owned ILCs from de novo interstate branching. We support that proposal.

Mrs. BIGGERT. But how about this; would you support the 85 threshold, or would that not happen at all?

Mr. ROCK. I think the 85 threshold is something that would probably work.

Mrs. BIGGERT. Okay.

Mr. Buell, do you have any comment on that?

Mr. BUELL. Actually, no comment on that.

Mrs. BIGGERT. How about Mr. Beal?

Mr. BEAL. We share the concerns about Wal-Mart unduly commanding a large segment of the market.

Mrs. BIGGERT. Thank you.

With that I will yield back the time.

Chairman BACHUS. [Presiding.] Thank you.

At this time I recognize Ms. Maloney.

Mrs. MALONEY. I would really like to follow up on Ms. Biggert's questioning. And I think she raised some important points. The GAO report released earlier this year also suggests that ILCs may need more Federal oversight regulation than is presently in H.R. 3505. And I would like to ask Mr. Hayes and Mr. Rock or Ms. Hart or anyone else, what specific dangers do you see from the ILCs, and what other safeguards would you like to put in the bill if you think there should be more restrictions put in? Anyone?

Mr. HAYES. I will start. You know, Wal-Mart's application to form an ILC is focused in their application to provide payment services. You know, I can set up a whiteboard in this room and explain to you how that ultimately would control the delivery of financial services to our consumers. I think the expansion that we feel will come—and you can go back to history and see how that organization has expanded—I think putting them under the regulatory authority of somebody like the Federal Reserve makes a big statement. It says you have to play by the rules.

And you know, we operate today as a financial institution under Federal Reserve rules and regulations. And I really feel strongly that any entity that is going to be in the financial services arena, especially an ILC, needs that, that oversight at that level, not just the FDIC, but a Federal Reserve oversight that looks beyond just one little segment.

Mrs. MALONEY. Anyone else wish to comment?

Mr. ROCK. Yes. ABA has always opposed the mixing of banking and commerce. That is our principal concern. We feel that the mixing of banking and commerce would create risks in the credit-granting process. And we also think that it would create a very risky concentration of economic power. And the economies that have gone down the road of mixing banking and commerce have struggled with it. So that is our principal concern there.

Mrs. MALONEY. Thank you.

Mr. Rock, there was a great deal of discussion in this panel from the members and from the panelists, and also from people you meet just walking down the street, about the burden of the CTRs and the SARs and the PATRIOT Act. This is a very serious issue because we want to crack down on money laundering and terrorist financing.

But could you just expand more what the burden is, why relieving that burden will not hinder FinCen and other FBI units and so forth that are cracking down on money laundering and terrorism?

Mr. ROCK. Absolutely, Congresswoman. And we think it is important. We want banks to play our role in trying to track down and eliminate the bad guys. We want to play that role. But I think what we have to keep in mind is that the CTR requirements that are currently in place were enacted 35 years ago. And since that time, we have had other provisions enacted; for example, the SAR requirements which were enacted about 10 years ago. And under the PATRIOT Act, we now have a 314(a) inquiry process. We think that those subsequent enactments are a more efficient way for law enforcement to prevent the types of illegal activity that they are looking to prevent than the old CTR process.

I mean, for example, under the 314(a) inquiry process under the PATRIOT Act which was recently enacted, if law enforcement wants to find out all of the deposits at a bank of 10,000 and over that were made in the last 3 years, they serve something on the bank that looks essentially like a subpoena and they ask for all of the records. So they don't have to go back to those CTRs that were filed.

In my bank, we file about 80 CTRs per week. And we calculate, by our estimation, that about 80 percent of those 80 per week—which is essentially 4 out of 5—have nothing to do with potentially criminal activity, and they are not being looked at by law enforcement. So we think that there is a lot of time and effort being wasted by bankers and by law enforcement in generating all of those reports when there are subsequent enactments that we think do the job in a more efficient way.

Mrs. MALONEY. Thank you.

And I would like to ask Mr. Beal, some banks have argued today and otherwise that large credit unions should not enjoy a tax advantage because they do not meet the criteria of the Credit Union Membership Access Act.

And would you like to respond to really, literally, some of the testimony today? I would say that I have represented many poor neighborhoods where the only banking services that were available were credit unions for the community. So I am a big supporter of credit unions, but I think that is a legitimate concern that was raised, and I would like to hear your response.

Mr. BEAL. Yes, ma'am. And we are happy to comment on that. The tax exemption for credit unions runs to the structure of the credit union, not the size. Credit unions are not-for-profit, member-owned cooperatives. They are owned by their depositors. They are mutuals. And that is what makes them tax exempt. It is not the fact that they are big or little. Credit unions have a good record

of reaching out to the communities that they serve, particularly the underserved communities.

Since 2000, credit unions nationwide have adopted about 1,200—actually, a little over 1,200 designated underserved areas, and placed branches in those areas to reach out and serve these underserved communities.

So the tax exemption is based on the ownership structure by the members and the not-for-profit status of the credit union. And credit unions are doing a good job of reaching out to the underserved, big and small alike.

Mrs. MALONEY. Thank you. My time has expired.

Mrs. BIGGERT. [Presiding.] The gentlelady yields back.

The gentleman from Texas, Mr. Hensarling, is recognized for 10 minutes.

Mr. HENSARLING. Thank you, Madam Chair.

Mr. Hayes, let me allow myself to welcome you once again. As a Texan, we are always happy to welcome Tenneseeans.

Mr. HAYES. Thank you, sir.

Mr. HENSARLING. We appreciate the loan of Crocket to Houston, but given what your Vols did to my Aggies in the last Cotton Bowl, be very leery of wearing out your welcome.

On Page 8 of your testimony you state: However, it is important to recognize it is far easier for most community banks to file CTRs rather than implement an exemption process.

So your organization doesn't seem to share some other organizations' enthusiasm for the seasoned customer exception. Can you give me a little detail on why you feel your community bankers will have some trouble?

Mr. HAYES. I think it gets down to the issue of defining in simple terms, so you don't end up in a Monday morning quarterbacking; you know, we should have done this. So, you know, if you look at the complexity of regulation that we face—and certainly in the consumer and the CTR filings, you know, we work through lists. But the reality is they are somewhat nebulous. And so every time you are faced with filing, you have to look and determine, you know, am I making the right decision?

So, you know, I think the complexity of what we have to deal with is the burden. And sometimes with limited staff—I mean, I have 50 people devoted to our banking operation out of 70. I am telling you, a lot of times they end up on my desk with our exemption book and saying, "Do we or don't we?" And quite honestly we do, so we don't get hammered.

Mr. HENSARLING. So is it a fair assessment to say, using the phrase "defensive filings" that you feel that this exemption will not diminish the number of defensive filings to any significance among community bankers? Is that your position?

Mr. HAYES. My position is that, but I think the solution is to raise the limit, raise the dollar limit. That way we are not dealing with as many of the situations that have to be there. We want to do our job. We are on the front line. We recognize that. But we have got to make this process work. And we think simplification of raising the limit is the easiest solution.

Mr. HENSARLING. Mr. Rock, welcome once again to our committee. In your testimony, I think you say that CTRs have been rendered virtually obsolete.

Would you answer the same question on the seasoned customer exemption and your feelings on raising the threshold in the CTR filings?

Mr. ROCK. Let me say, first of all—and I haven't had the benefit, Congressman, of reading ICBA's written testimony for today yet, but I am familiar with the positions they have taken in the past. And I do think that what I have heard Mr. Hayes say in the past, and ICBA, is that the present exemption system that exists is so cumbersome that many banks do not take advantages of it. And I agree with that wholeheartedly. I think that is a little different from what we're talking about with this seasoned customer proposal. So let me make that distinction, first of all.

Secondly, in terms of saying that they are obsolete, as I said in response to Congresswoman Maloney's question, we have many more efficient ways today for law enforcement to collect that information, and for us to give them the information, that didn't exist 35 years ago.

That 314(a) inquiry process—and the last time I looked, it had been used 684 times by law enforcement so far this year—that 314(a) inquiry process is much more specific and much more efficient. And that is why we think that filing those reams of paper—and there were more than 13 million of those reports last year—we think that that is what has become obsolete.

Mr. HENSARLING. Mr. Rock, I think you are aware of the portability issue within the CTR context. There is still somewhat of an ongoing debate about its propriety. Could you speak to what burden it would be if we didn't employ portability language?

Mr. ROCK. Well, I think, quite simply, each time that someone changed banks, we would have to do it all over again. We would have another 1-year waiting period. And I think that that would substantially impact upon the number of CTRs that we would reduce. Now, by how many, honestly I can't say to you because we haven't lived under that regime yet. But I think that it could—the exception could engulf the rule, and we could—the new rule—and we could substantially reduce the number of CTRs that we were eliminating by the process.

I understand the concerns of the committee, and we would welcome trying to work with you on better defining that portability issue.

Mr. HENSARLING. I see my time has expired so I yield back.

Mrs. BIGGERT. Thank you. The gentleman from Pennsylvania, Mr. Kanjorski, is recognized for 5 minutes.

Mr. KANJORSKI. I will pass for the time, Madam Chairman.

Mrs. BIGGERT. The gentleman from Tennessee, Mr. Ford, is recognized.

Mr. FORD. Thank you, Madam Chair. I didn't get a chance to welcome fellow Tennessean President Hayes who leads the ICBA effectively. Thank you, sir, for being here. Thank you for your comments.

Ms. Hart, it is a pleasure to see you as well and see the National Bankers Association represented here this morning. I didn't know

if on any of the questions—I saw you were looking at some of your notes—if you wanted to answer or provide any insight or additions to what might have been said to the last two questions. I know Mr. Hensarling didn't direct it to you; it looked like you might have been jotting something down.

To Mr. Hayes, you spoke eloquently and you answered Jeb's question, Congressman Hensarling's question well. You talk a little about bit—we talk a little about how this bill will help institutions be more responsive in the case of a terrorist attack or a natural disaster. A lot of that we can kind of guess. But we have seen in recent weeks, last 2 weeks, some of your members from the area from along the Gulf Coast complain about some of the challenges they are facing.

In addition to what is discussed and contemplated in this bill, what more could be done or should we be doing to help alleviate some of the burden that your members—and I would direct it also to Mr. Rock who is very passionate in his responses, if he wouldn't mind sharing with us as well, some of his members who may see us do things outside this bill to be helpful.

Mr. HAYES. Congressman Ford, thank you. We have early on been passionate about the needs on the Gulf Coast. You know, we have family; we have grown up there; and we have friends there. And you know, when you are faced with a disaster of the complexity that has been there, there are many things. And we have been very definitive in putting forth a list that is very long, of specific things. And rather than going through that in detail——

Mr. FORD. I have seen some of them. You have given me some of the two or three bills, things outside of the things in this bill, that could be helpful quickly as we try to consider things on this committee.

Mr. HAYES. I think, you know, I would rather respond in writing back to you, Congressman Ford, on that because I would want to prioritize them. And I can do that in the next day for you. But I would say to you that action is first and foremost. We have got to do some things to help take away the paperwork burden.

I am sitting here thinking about friends there that really don't have computers to do the kind of things that they need to do in order to assist the people. And so we have got to figure out a way to say, okay, that is fine. If you don't dot the ″I″ and cross the ″T″, you know—if somebody comes into my bank with a FEMA check, they may not have IDs. I need some protection. I want to help those people. I am passionate about helping those people.

So I think we really are at a point where it is action. And specifically, you know, there are some things there that I would just like to write back to you today and tell you specifically.

Mr. FORD. Yes. I know Ms. Biggert has a similar concern. We have read some of the problems that the SBAs have processing things and how lengthy the applications are.

I know my time is up but, Mr. Rock and Ms. Hart, what you've heard from your members along the same lines and what, outside of what we are doing now, can we help to expedite the facility?

Mr. ROCK. I would say the single continuing thing that comes to my mind from my discussion with my friends from Louisiana and Mississippi would be issues relating to indemnification for people

cashing checks, taking risks that might be otherwise extraordinary but in this environment are necessary. You know, folks that come in with handwritten checks that have no printing on them but purport to be Government checks and they don't really look like what we are used to seeing as Government checks. Those folks have no identification. And yet they are very, very needy. They need their money now. They need it to eat. And they need it for other important reasons.

And we have had a lot of bankers like Guy Williams in Louisiana who has gotten some notoriety, people who have stuck their neck out a little bit. But I would hate to see those things come back to haunt them from the few that are less than on the up and up. So that is the issue that comes to my mind, Congressman Ford, indemnification issues for people cashing checks for folks in dire circumstances.

Mr. FORD. Mrs. Hart?

Ms. HART. We have three banks in the Louisiana area that are very burdened right now and had to leave, and some were operating in Baton Rouge, Appaloosas. They are having a rough time. So we really need some assistance with all of the things, the trials and tribulations that they are going through right now.

Mr. FORD. Madam Chair, thank you for the liberty with the time.

Mrs. BIGGERT. Thank you. The gentleman still has 22 seconds.

Mr. FORD. We can't count where I am from. We keep losing football games. I am glad Hensarling said something nice about us. But I am always delighted to see David Hayes. I wasn't present when you were introduced.

Mr. HAYES. Thank you for being here.

Mrs. BIGGERT. Thank you.

The gentleman from New Mexico, Mr. Pearce, is recognized for 5 minutes.

Mr. PEARCE. Thank you, Madam Chair.

Ms. Hart, in your testimony you talk about potential for some of the provisions in the regulatory relief to help serve the underserved, the low income. Short description of what you think that—how that might occur.

Ms. HART. We have many banks that are in neighborhoods where they need the assistance to help their customers.

Mr. PEARCE. And the rate relief has provisions in it that allows that to occur?

Ms. HART. Yes. Also, with other banks coming in right across the street that may offer better services, that would worsen the effects of what they are going through.

Mr. PEARCE. Forty-seven percent of my district is Hispanic, and they generally have below 50 percent utilization of the banking institutions. So you also mentioned that you thought the ILC should be limited, but if that were allowed, the staggered rollout should occur. How would you view a staggered rollout as being effective?

Ms. HART. Well, I need to get more materials to you. But I just know that with those type of businesses there our banks would suffer because they wouldn't be, you know, allowed to still continue what they do generally.

Mr. PEARCE. Mr. Beal, Ms. Maloney had asked—Congresswoman Maloney had asked a question. And your answer, I think I missed

one piece of that, and if you wouldn't mind giving an answer to her question. You said that the tax provision is based on structure, not size. But her question dealt with membership, the broadening of membership.

Would you try to answer that question with respect to membership of credit unions?

Mr. BEAL. Yes, Congressman. I apologize if that answer——

Mr. PEARCE. Okay, Mr. Beal.

Yes, I was looking at the other person. I have got my notes correct.

Mr. BEAL. I have forgotten the question.

Mr. PEARCE. Just about membership.

Mr. BEAL. Oh, broadening the field of membership. The field of membership rules have been broadened somewhat over the years; there is no question about that. Credit unions remain limited in who they can serve. They are limited either to a specific employer or group of employers or a well-defined local community.

So even though there has been perhaps some broadening over the years, they are still very limited. We are not open to the general public, to anybody in the whole word.

Mr. PEARCE. And the credit unions do, like Mrs. Maloney said, serve a very valuable part of our constituency. There are communities of 2- or 3,000 people who don't have it, so I do appreciate your presence in the communities.

Mr. BUELL. Congressman Pearce, could I add to that as well? I agree with that. We are a community-based credit union there in Lima, Ohio, and we do have a fixed—as far as geographical area that we can serve. At the same time, we do try to do a very good job in terms of focusing on low to moderate income.

One of the things that was in this bill that was very advantageous to us was to allow us to cash checks and remittance services to individuals without them becoming members just because they are in our area. We do have several individuals who are on banks, so we can actually serve them.

At the same time, we maintain three branches within underserved communities, within the Lima area, and we have actually applied for an application and been approved, where we can go to another rural location that is an underserved community as well, so we can provide housing.

Mr. PEARCE. You understand that Mrs. Maloney's point was well taken, that there are many who argue that when you begin to broaden membership, then it begins to really negate the argument for the tax provisions. And I just want to make sure that we address that.

Mr. Rock, you have I think drawn a conclusion that I share, that the economies that makes banking and commerce generally having difficulty. Would you give me your definition of commerce?

Mr. ROCK. Well, I think that the efforts that have been made in some other legislation, which are proposed here, which say that if more than a certain percentage of your revenues come from nonfinancial activities, I think that that is probably a good way to go about defining what is financial and what is commercial.

And I think that was the 85 percent rule as I proposed before; I think that is probably a workable rule.

Mr. PEARCE. Actually, I was looking for a broader definition, not in banking terms of commerce, but that is okay.

Mr. Rock—sorry, Mr. Hayes—you communicated deeply I think your feelings about Wal-Mart. And I understand that we have got small communities where the same thing has happened, but I also have small communities where the people are saying that my purchasing power now is going 20 percent further, and that is the value of competition.

If we try to extend that one step—and I don't think you and I are very far apart on the ILC's—but in looking at the arguments, if we extend that concept of competition as being the question, how would you perceive that the ILCs are in danger, if you look purely from a competitive standpoint? You have Mr. Rock's evaluation that mixing commerce and banking has been bad for economies. But your approach seemed to be from a competitive standpoint and what they have done in the communities. Can you give us just a little bit of an input there?

Mr. HAYES. My position is Wal-Mart should not be in the banking business.

Mr. PEARCE. I understand, but you don't like them in the communities and you don't like what they have done in the communities, but yet they have extended purchasing power which has allowed our economy to stay growing pretty strongly.

Mr. HAYES. No question. And I have stated that it is an economic issue in our community that provides services and products, primarily products that may not have been available in rural markets if you go back to the early days.

But I think when you get to size, size can put you in a mode of control. And I think that the issue I see is the control that sets in one company—over 25 percent of the retail business in this country is controlled by one entity—has pluses but it has a lot of minuses. I like to play the game on a level playing field. And I think that if you looked what that kind of company can bring—and a scenario would be if you have our checking account services, we will give you 3 percent off your purchases in Wal-Mart—somebody is paying for that. And I think that is the undue competitive pressure of mixing that banking and commerce, is that you can deliver that.

I don't mind competing. I don't mind competing with anybody. I just like that the odds are level and we can suit up and play the game hard.

Mrs. BIGGERT. Gentleman's time has expired. Gentleman from California, Mr. Baca.

Mr. BACA. Thank you, Madam Chair.

My question is for Mr. Beal. Mr. Beal, providing relief for the recent hurricane has been the top priority for Congress and will be for some time. Which of the credit union provisions in the regulatory relief bill, if passed swiftly and signed into law, would make it easier for victims, both credit unions and members, to get back on their feet?

Mr. BEAL. Sure. Thank you, Congressman. I think one of the provisions certainly would be the remittances and check cashing. I know in our community in Las Vegas, we even have folks from Katrina who relocated out there. And they may or may not be a member right now, but if we can help them with check cashing or

remittance, wire their money back home or off to relatives, I think that would be quite a relief for us and certainly for the credit unions in Louisiana and the Gulf Coast area that would help them as well.

Mr. BACA. Mr. Buell?

Mr. BUELL. I agree with that. One item, first of all and foremost, is help them do basic financial services. The one nice thing within the regulatory relief bill was also exempting the faith-based loans from the business cap. So, again, helping rebuild churches, help rebuilding other faith-based organizations in those areas, credit unions can hopefully step up and help in those areas as well.

Mr. BACA. Thank you very much. I think that is why it is very important that we do take up this legislation and provide services—and this would be swift—and signed into law and be able to provide that kind of assistance.

My next question is for Mr. Beal. In your testimony you made reference to a study issued by the Small Business Administration that details the decline of small business credit availability. One of the concerns that I have is minority-owned businesses only comprise about 15.1 percent of all businesses. And we know that throughout our Nation they are basically growing in each one of our communities, and an empire is made up of basically small businesses.

Can you explain why credit unions are uniquely positioned to fill the gap in services to small business owners lacking access to capital and how the provisions of CURA to raise the current 12.25 cap to 20 percent and the loan size from 50- to 100,000 would help credit unions better serve the members who are small business owners?

Mr. BUELL. Be very happy to answer that question. We at Superior, this past year we started up our full service member business lending program. Before we just did 1- to 4-family and rental properties type things. But since we actually brought a commercial individual on board, we have had just great success with our members. They have been asking for these types of loans.

And when we talk about large loans, our average size is about $100,000. And I am concerned right now when I see that, as we mentioned in our testimony, we are at 5.5 percent already. And we project if we keep seeing the same member demand that we see right now, we will be at 12-1/4 percent cap in the next 12 months.

Banks in our area, have some good banks and good—great community banks. But when you take a look at the $100,000 dollar loan, the $50,000 loan, and the $75,000 loan, the local institutions might be wanting to say, yes, we will do that. It might be 2 or 3 weeks before we get back to them because of the size of the loan. We can step in right away and help fill that gap and provide that type of capital.

We are helping the small business owner; we are helping the landscaper, the guy opening the flower shop. We are actually financing an Amish fertilizer truck. These are different types of loans small business is looking for that we are willing to step in and help make. There is a demand out there. We just didn't grow that quickly over 6 months by making risky loans. We have made

very good, nice, secure loans. There is a strong demand out there. We are going to need some relief.

Mr. BACA. So the availability to provide small business loans would be a lot better and can be provided to the credit unions because you have direct access to individuals—and in the growth and population.

Ms. Hart, you mentioned in the other case, in the banking industry, you are very much concerned that there is lack of services or that we need to address to make sure that the banking industry continues to provide assistance to minorities and women. So apparently—is the banking industry having a problem in reaching out to minority businesses or not, or do they need to work in that area to make sure they ensure that a certain percentage also goes to minorities and/or women?

Ms. HART. Yes. Businesses need to support minority-owned businesses as well as banks.

Mr. BACA. Why isn't the banking industry reaching out like the credit unions are reaching out to small businesses within the communities?

Ms. HART. We are reaching out, sir. We just have not gotten a strong enough defense and help in that area.

Mr. BACA. Thank you. Mr. Hart, in your testimony—and I want to stand corrected—it seems like you are not open to competition at the very beginning of your statement. Is that true or not? Or do you believe in open competition? Mr. Hart? Mr. Rock, I am sorry.

Mr. ROCK. I am sorry, Congressman. I thought you were addressing Mrs. Hart.

Mr. BACA. No, I meant you. It seemed like in your statement you weren't open to open competition. At least that is what I thought I heard.

Mr. ROCK. No. I think quite the contrary. We welcome competition. I don't know whether you are addressing the ILC issue or credit union issue, but with regard to ILCs what I said is we are not afraid of competition. We are afraid of the consequences of the mixing of commerce and banking. That is what we are afraid of.

With regard to credit unions, we are not worried about competition at all. We want to compete on an even playing field. The credit union next door to my bank is over $2 billion. They are more than double the size of my bank. They can do business with everybody that I do business with, and they offer every single product. Their, quote, "local community" is over 2.8 million people, and yet they pay no taxes. And we pay taxes. They are not tested on CRA, whether they lend to minorities and small businesses, but we are. That is not equal competition. I welcome equal competition and suggest that they should convert to being a mutual financial institution.

Mr. BACA. But they are providing a service which is good.

Mr. Hayes, I know that my time has expired, but you touched on something that is very important to a lot of us that we have looked at, and that is when you mentioned Wal-Mart. What provisions would you suggest need to be done when you look at the competitiveness and what they are doing right now that needs to be regulated?

Are there any suggestions or provisions that you have or recommendations as you look at Wal-Mart versus any other institution?

Mr. HAYES. I think there is a—you are speaking of them getting into the ILC?

Mr. BACA. Yes.

Mr. HAYES. I think falling under the Bank Holding Company Act and having to comply with the Federal Reserve oversight, if such charter were granted to them. I think that is where the rubber meets the road because, you know, they are so large that you can carve it out and you are not going to really effectively look at it. It has to be the total impact and what are the items that are going forth in their company that are across those lines between the retail side and the other. And we are not afraid of competition, absolutely not. We just want it fair. And the regulations have to be there.

And I would like to respond on the credit union items just a second. I am not afraid of competition. I am not afraid of competition. And I will tell you, we serve our communities. We serve our customers. And they have my phone number and I am out there. I am doing those things. So it is not an issue of service. It is not an issue of service. It is an issue of fairness.

Mr. BACA. Good. We all need to do that. Thank you.

Mrs. BIGGERT. The gentleman's time has expired. The gentleman from Texas, Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you, Madam Chair. I want to go back to the regulatory relief portion of our discussion here. There has been a lot of discussion, as I have traveled around community banks, about CTR and SAR provisions in this bill and because it is, quite frankly, creating a lot of paperwork and a lot of issues for our community banks.

And I guess I would like for some discussion or response, say, to have we gone far enough in this bill or should we have done more? So I will just kind of go down the line there. Mr. Beal?

Mr. BEAL. Thank you, Congressman. For our credit union, it is a burden as well, although maybe not to the extent of some of the community banks. We file about 40 to 50 CTRs every month. Since we are mostly a consumer organization, we don't encounter perhaps the volume of transactions or at least the size of the transactions that others do. But we do need some relief there, and it does consume a substantial part of our resources and assets due to that.

Particularly the area we struggle most is with the structuring issues where we need to try to detect where aggregate deposits exceed the threshold amount. And that is going to require some further programming, some further changes on our side.

And so I would also echo the comments of some of the other panelists, that a lot of these things are submitted, perhaps it is a disservice to law enforcement as well because they can't really deal with the volume that they are getting.

Mr. ROCK. I think that the proposals that have been put forth in connection with this bill would go a long way toward reducing those needless piles of paperwork. I think that the item that is not currently in the bill, but there is kind of a place for it, would deal

with the seasoned customer. If you have had a seasoned customer for more than a year in a transaction that counted those, you would not have to file CTRs. I think that would go a long way to eliminating the piles of paperwork.

I think the other provision that is in the bill which has to do with stopping the reports of SARs necessarily to the board of directors, I think that is a micro-managing type of report that is meaningless to my board, and I think that that provision in the bill would also go a long way towards starting to cut down on some of the meaningless paperwork.

Ms. HART. I applaud this bill, and we would like to work closer with Congress to find a niche for the minority banks so they wouldn't be burdened as much as they are.

Mr. BUELL. The CTRs who do not file $174 million on the average member account size is about $4,800, so we do not have to file very many of them. At the same time, we do concur in streamlining the process and actually having the regulation to do what it is intended to do, which is to catch the bad guy versus making other Americans having to be subjected to this.

Mr. HAYES. First, I think that we need to raise the limit. Secondly, let me respond, then, on the SAR issue. It is frustrating to file a SAR and, you know, get a call back that says that is not large enough for us to take our time. So I think you sit there and you say I am doing what is right; I am doing what is required of me as a banker and as an American, and yet I reported something, and it is not big enough.

It is not big enough. I lost money maybe. It is not big enough.

So, you know, I think we have to understand that bankers every day are on the line, eyeball to eyeball with their customers, and filing this paperwork that really in some cases gets no results. It just tears your heart out to say, how can I motivate my people to keep doing this? And so I think raising the limit up to where it is inflation adjusted, that is a great start for all of us. But I think because so many are filed, and the dollar amount may not be big enough, is a demoralizing thing for somebody who is on the front line.

Mr. NEUGEBAUER. Mr. Rock, have you heard an examiner say you are not filing enough SARs and you are not filing enough CTR reports? Do you ever experience that?

Mr. ROCK. I have not personally, Congressman, but I have had it reported to me by many of our constituent bankers that they have told them that that is the problem. They say you are not filing enough, and I say I didn't know there was a quota system in any reg. And they say there isn't a quota system. I said, well, I don't understand. It is just not enough for a bank your size. We want to see more.

I think it is those types of discussions in the field with examiners that have resulted in the so-called defensive filings. People have kind of shrugged and said, well, if they want more, I will give them more.

And I am concerned not only about the time and effort and wasted banker time and money, but I am concerned about the broader issue about what that does for our law enforcement efforts. I think that it drowns the law enforcement people in piles of paper and, in fact, is counterproductive for law enforcement purposes.

Mr. NEUGEBAUER. I see my time has expired. Thank you, Madam Chairlady.

Mrs. BIGGERT. Thank you. The gentleman from Pennsylvania, Mr. Kanjorski.

Mr. KANJORSKI. Thank you, Madam Chair. I apologize for getting here late, but I love to enjoy the food fight. I thus appreciate some of the comments. I am certainly not mocking or making fun of Mr. Hayes.

Mr. Hayes you said you want to compete on an even playing field, but yet you do not want to compete with a credit union, and then you defined why they differ. We, however, are here trying to provide easier access to activities by banks, credit unions, and every financial service institution.

I also noticed you really did turn white with the mention of ILCs and the United States and Wal-Mart's application for one.

I think there are challenges out there. If I had my druthers, we would go back to the drawing board and have only one type of financial institution in the country. Then we would have a very different marketplace—but we all know that is not the case. We have all these institutions built for different reasons and at different times stimulated for different purposes.

I actually think I have two things I am interested in. One, I have always been interested in economic developments. And some of the questions here mentioned how can we facilitate the small businessman—faster response, need for money. Sometimes very larger institutions really aren't interested. It is not their fault. It is just they have other fish to kill. And on the other hand, we have this big 800-pound gorilla out there that is saying let me into the game.

And if they get a license, it will be maybe not letting them into the game, maybe at the end of the game for a lot of you fellows, community bankers, independent bankers that I am interested in. So I am not sure your artillery isn't directed at the wrong front, if you will.

You probably have differences. All of us in Congress have been trying to work out that common, fair, playing field, taking into consideration all the nuances and structures of the institutions. But a very fundamental question is going to be made in the next several months or years. And certainly some of my colleagues are getting extreme pressure.

I want to be frank. Up until this point, to appeal to you, Mr. Rock, I have been hard core. I really believe there should be a separation of banking and commerce. When I sat on the conference committee for the Gramm-Leach-Bliley Act and we almost got the nose under the tent—myself and several other colleagues were vicious in our fight. And I tend to remain that way, although I say that, hey, if intrafinancial service providers are going to start throwing Molotov cocktails and internal attacks, the best way for us to solve that problem is to say, you really want open competition? Absolute, open competition in every stretch of the imagination? Qualify the ILCs from Wal-Mart, tear down the wall between banking and commerce, and let you guys all go at it. Unfortunately, we will pick most of you up as casualties. And it is sort of unfair for you to say we want to compete on an even playing field. Well, you know, you really don't. You really don't. Nor can you.

Let me recall something for many of my colleagues that are here for a limited period of time. In the 1991 Congress, a famous Senator, who chaired a committee of equal jurisdiction in the Senate, and the President of the United States sent us some indications that they wanted to institute a 10-1/2 percent interest rate on credit cards. I don't know if all of you were in banking in 1991, but the banking industry in 1991 was probably in a negative position in equity. They were the next savings and loan crisis of even much larger proportions. And the appeal of putting a cap on credit card charges certainly appealed to this side of the aisle's constituents. But it would have stripped the capacity to build the equity of banks. And rather than doing the political thing, we did the rational thing. We said, let's see if we can't—not to have a government program for rescue or disaster and then a rescue occur for banks—let's see how they can work it out. And they did. Quite frankly, we reconstituted the equity of banks in this country for a period of time of 2 or 3 years and allowed them to be more competitive even in the credit card field, which is good.

That is what Congress is all about, to give an opportunity for someone to breathe before they have to get up and run.

And I would just like you all—I am not going to really ask any question, unless you have something you can tell me what you can do for economic development. But you know, rather than this intrafinancial service industry food fight that we tend to have on a periodic basis, why don't we all think about what we can do for all of the institutions to make them serve better, be more competitive, make more money, and maintain the wall between commerce and banking? Because quite frankly, you use all your energies fighting each other. Our solution is open it up to total competition. Let the ILCs in.

And I can tell you, my prediction is Wal-Mart will eat you all alive. They will eat the credit unions alive, the community banks alive; they will eat even the big banks alive. Nobody could withstand that type of 25 percent retail. It is mind-boggling. Of course, nobody in America that works for a living will have any pensions; they won't have any health care; and they will be making minimum wages. But, hell, that is what we want anyway, isn't it?

I want to ask you—I don't want to put you on the spot—but if you can see anything that we can do in this Regulatory Relief Act to make it more attractive and simpler and easier to help stimulate particularly the middle and small business communities, with whatever institutions. Certainly I have been very instrumental in encouraging credit unions to fill that void out there, but if there are other things we can do, let us know.

I do certainly encourage—I have been a big supporter and we will bring that government-sponsored enterprise bill. I think that is very important, to have the Federal bank system interact with the banking community and make funds readily available that can be used for these purposes, but I would be interested in it.

If you have any ideas, certainly let me know and let the committee know what we can do. We are going to be marking up these bills in the next couple of weeks. Maybe we can do something constructive.

Mrs. BIGGERT. The gentleman's time has expired, but I knew that there would be somebody who would come along to stir the pot, but thank you for your comments.

The gentlelady from Wisconsin, Ms. Moore.

Ms. MOORE OF WISCONSIN. Well thank you, Madam Chair. I guess I would like to associate myself with the comments of Mr. Kanjorski to a certain extent. You know, I was sitting here listening very carefully to the questions and some of the responses of the distinguished panel. And I find that we are really, as Members of Congress, on the horns of a dilemma. I certainly—and I guess I am making a statement more than a question—I am sympathetic to the banking industry about the, what, depends on whose numbers you believe, $42 billion a year that it costs to regulate, to be regulated. But at the other end of that dilemma really are terrorists funding. The sex trade, we have heard testimony in the subcommittee about the sex trade yielding as much or more than all the military budgets in the world. We hear your concern about the CTRs and about getting some regulatory relief around so-called seasoned customers. And we hear about the banks not being responsive to smaller businesses and minority- and women-owned businesses.

We hear the credit unions who serve a particular constituency. I started a credit union from scratch myself. I love credit unions. And I appreciate that it is a movement more than anything else, because they do, as you have indicated in your testimony, Mr. Buell, have a real mission. These are member owned, democratically operated, not-for-profit organizations, and have volunteer boards of directors. But yet you would ask us for more powers to raise the cap on the amount of business loans that you can provide, and to have the capacity to examine third-party vendors. You want a separation of banking and commerce. But at the same time, you want to sort of blur the lines between this member-owned business and getting out there into the marketplace.

I guess if I were to ask a question of any of you all, the first question I would ask is, when we look at trying to, you know—so this is the horn of a dilemma, because I do think that things like this, for example, the sex trade proceeds. I mean criminals seek so-called seasoned customers, or they develop—if we were to believe any of the old crime boss movies, that legitimate businesses are established to launder money through it.

So I guess I am asking for you to point to us what provisions in this Regulatory Relief Act are too onerous and what do you see as a streamlined way. Just point to us what provisions in H.R. 3505 are going to accomplish both the purposes of giving you some relief as well as sort of putting a kibosh on laundering money.

And I would ask, Mr. Buell, about the credit union, about that dilemma. How can you have it both ways? How can you be a membership organization that meets the needs of your members and yet seek authority to really put capital out in the more commercial world? Thank you.

Mr. BUELL. I would be happy—it is directed to me. I would be happy to answer the question. You know, I think at Superior—I speak on behalf of us—we are a member-driven organization. I have members that are low income, and the service that they are

looking for us is to cash a check on a weekly basis and not charge them a fee, and we do that. I have members who want used car loans so they can go to work, and we happily do that for them. We have members looking to buy their first home. And we do a very good job of that as one of the leaders in our community, as far as doing that.

When we talk about expansive or little broader powers, the one thing we are seeing right now, again, is that void with the small business loan. Is that a riskier loan? It is not. Actually, for us it is a much safer loan. Of the ones we have done already right now, we have absolutely zero delinquency with these loans. But there is a void out there. We are trying to fill it.

No matter how a member comes to me, whether it be for a small business loan, whether it is for their first child's savings account, my job is to help facilitate it. I think sometimes I am the intermediary between a saver and a borrower, and as a cooperative they are coming together to pool their resources. And my job is to help facilitate that, and that is why I need additional regulations to give us more help in doing that.

Mr. ROCK. I appreciate your desire to balance the need for catching the bad guys, finding money launderers, with also wanting to reduce needless regulation. That is what we want, too. I think, for example, we have a lady in my bank who has been in her job for more than 30 years. She is the one who works on identifying so-called suspicious activity and then filing the SARs.

If her and her staff, if they are spending most of their time filing the CTRs from 35 years ago and just filing these huge amounts of paper, that prevents her from spending as much time on the SARs, which is really identifying truly suspicious activity—a much more limited number of reports, fewer pieces of paper, but more meaningful pieces of paper.

We are not suggesting changing those SAR requirements at all. I think that is the more effective area for both bankers and law enforcement people to spend their time.

Mrs. BIGGERT. Gentlelady's time has expired.

Ms. MOORE OF WISCONSIN. Madam Chair, thank you for your indulgence on the time. I had one follow-up question for Mr. Buell, but, Ms. Biggert, your indulgence is required.

The other part of my question—thank you so much, Madam Chair. The other part of my question to you was, you know, you seem to agree with everyone on the panel that we need to separate commerce from banking. You don't agree with that?

I did really appreciate your sort of delineating the services that you provide to members because indeed I think that is the mission of the credit union to do that. But once a member wants a loan for—you know, not working-out-of-her-home type mom thing—I just want to buy a computer so that I can work out of my home during maternity leave and catch up with my e-mails, why then don't we send those same customers to a bank?

You know, once they are in a position where they actually want to be a housing developer, want to build a community, apartment building for low-income housing, why do you see that as your mission?

Mr. BUELL. Well, first of all, I would like to clarify. On the ILCs, we really do not have a position. As far as we do understand the concerns, we think, you know, no one has the right to dictate that, you know, the business practices of that with the ILCs. On the other side of what she was talking about, you know, the small business loans, there does there come a time where it matures and it gets handed off to a larger organization. And there are going to be times that is going on happen. I mean, we are going to help someone get started, and they are going to want to do a land development loan. And they are going to want—you know, in my case, my average loan size is $100,000. They are going to want $3 million. We have a good relationship with our local bankers. They send us some business, and we call them up with someone we trust and say, here is what this individual is wanting to do. They are wanting to improve their community. You know, if we can help facilitate that, my job is to help the members. Sometimes I am the best deal. Sometimes I am not. But whatever case that is, it is our job to advise them, educate them, and to help them to do what they need to do right there at home.

Mr. MOORE. Thank you.

Mrs. BIGGERT. [presiding.] The gentlelady's time has expired.

The gentlewoman from Indiana is recognized for 5 minutes

Ms. CARSON. Well, thank you very much Ms. Chairman, and I apologize for being late. I had two committees at the same time, transportation, entertaining information from Wynton Marsalis and the Governor, et cetera, from New Orleans and Mississippi, and I apologize for being late getting here.

We have been hearing in the past subcommittee hearings, the Federal Reserve Board estimates that the banking industry spends about $36 billion to comply with regulatory requirements at both the Federal and the State levels. I certainly don't want to impose that kind of cost on the financial industry. And while many regulations are in place to ensure consumer safety and enforce compliance with versus consumer protection statutes, some do prevent banks from effectively serving the public and drive up the cost of doing business. I have a bank around the corner from me where I live who stopped taking Federal checks on deposits from people who have no accounts at the banks. They feel like they are losing millions and millions a year by cashing those checks. Smart as the banking industry is, I am surprised you haven't come up with a solution or a system whereby you can still serve the public in that way. Some people are afraid to have bank accounts. I guess they think back to the 1930s where people lost all their money in banking institutions. Notwithstanding, our job as a committee is to make sure that we find a balance between protecting the American people and their financial endeavors and protecting the industry and providing regulations to ensure effectiveness. So these hearings have been a great help to me in terms of trying to understand the banking industry has, in fact, come a long way. You have eliminated a lot of your bias that you had.

Historically, it seems that you do a better job in weeding out all of that, but what I would like to know is, what does the financial industry, how do you respond to community investment? That is what is required by financial institutions. How do you respond to

community reinvestment, and how do you explain trying to get rid of it? That is my question. You are trying to eliminate community reinvestment with resources. How do you explain that and still be accountable to the customers which you serve? I don't make myself clear, do I? I have got a bad cold. I apologize, but try to work with it anyway. Okay?

Mr. HAYES. I lost my voice over the weekend, so I can appreciate the struggle of doing this. I have been a community banker now for 15 years. I moved from a large metropolitan city to a community of 19,000 which has offices in a community of less than 2,500, less than 4,000 and less than 500. It is my responsibility to have the job that I have to ensure that my community and the people in that community grow, that they have a job. I spend an enormous amount of my time working trying to bring jobs to our community. I spend time working with schools to ensure that there is a connection between the education system and the private sector so that our young people will have an opportunity. I tell our young people every time, don't do drugs, study, because it is, in fact, what you study and how you apply yourself is how you will be successful in this country. We spend an awful lot of money in our bank putting money into our community for those things—education, jobs and people. People come to us and say, we are doing this. Can you furnish us money to do that? We do the right thing. Sometimes it is tough to sit and document that you do the right thing. I mean, we are people. We want all of our citizens to have success. So the Community Reinvestment Act is sometimes a documentation of, did we do the right thing.

And I can tell you sitting here, or wherever I go, I do the right thing for people in my community. And my community, you know, my average loan is less than this gentleman's. My average loan is $25,000. I finance used cars. I finance computers. I do those things. I am a community banker.

Ms. CARSON. Well thank you very much. I appreciate that. I have had a lot of town hall meetings dealing with financial literacy. As a matter of fact, Alan Greenspan was one of my principal speakers at one of them. I don't know whether I think you should do it, but probably so. Educate the community on financial literacy encouraging young people to invest even if it is just $5 a week.

Mr. HAYES. Congressman Ford and I have had many conversations about financial literacy, and you may not like my response. But you know, when a nation is running a deficit, it is tough to communicate to somebody you have to live within the means which they are afforded, and so we have to—Congress and those people that are on the line talking with these people have to say, you have got to concentrate on improving yourself through education and working hard, and we are there for you.

I mean, I am passionate about this. And I can assure you, I wish as a young person I had had somebody there to help educate me. And I am willing to do whatever it takes. You know, if the Lord's willing and I am going to be here a few more years, you know, my passion when I don't have to come testify is to be out there helping young people understand the importance of education, not doing drugs, and understanding a dollar is dollar, and you have got to work for it.

Mrs. BIGGERT. The gentlelady's time has expired.

Ms. CARSON. Thank you, Madam chairman

Mrs. BIGGERT. The gentlewoman from New York is recognized for 5 minutes. Mrs. Kelly

Mrs. KELLY. Thank you, Madam Chairman. I apologize for being late. But I am very interested in what this panel has done. I have read testimony. I am very interested in what this is all about. I have a question about a bill that Mr. Royce and I have introduced that I would like to ask you your opinion on. We have introduced H.R. 1952. It would create a treasury certification system for foreign governments that will give our banks and their customers access to the best idea of what the U.S. Government knows about what other countries are doing without imposing a new bureaucratic structure on the private sector. I would really like your input on whether or not you think such a system would be helpful to you in dealing with foreign banks and foreign entities and foreigners themselves. And let's start with anyone of you who is willing. You are all looking at me. This may be something that you are aware of. It may not be.

But Mr. Beal, you are on this end, so I am going to ask you if you have got any comment on that.

Mr. BEAL. Certainly. And thank you very much. It sounds like an interesting idea. I confess I wasn't previously aware of it. We would be happy to take a look at it and study it a little further and get up to speed on it, but it does sound intriguing and interesting. And it may prove helpful to us because we have encountered some difficulties in outbound remittances particularly to Mexico and points south. So that could be helpful to us from that perspective.

Mrs. KELLY. Good, that is what we are hoping, is that perhaps that might help reduce the regulatory angst that goes on about all the CTRs and SARs and so on. And so Mr. Rock.

Mr. ROCK. Thank you, Congresswoman. I am not familiar with the terms of H.R. 1952, but I do think that, as Mr. Beal said, it is an intriguing idea to me. I think that perhaps some sort of certification process could be helpful to everyone on all sides, and we would like to work with you in trying to explore those pockets on whether or not it can be helpful.

Mrs. KELLY. Thank you.

Ms. Hart.

Ms. HART. Thank you Congresswoman. I would like to see your bill also. Thank you for the opportunity. But for the most part, our banks don't have a lot of foreign activity. But I would like to see your bill.

Mrs. KELLY. Wonderful.

Mr. Buell.

Mr. BUELL. As Ms. Hart, as well I have not seen the bill, and we do not have a lot of foreign activity or any actual foreign activity with the foreign banks.

Mrs. KELLY. All right.

Mr. HAYES. It is an intriguing idea. I must admit I don't have any knowledge of the bill. But having spent 9 days in China visiting with the banking authorities over there, you know, I think it is important for all of us to understand, you know, the impact that the foreign countries and their companies have on the business

that we do. So it is something that we need to ratchet up and look at and deal with that, and we will respond to you ma'am.

Mrs. KELLY. I appreciate that. Clearly, our emphasis is to try to help U.S. banks and anyone doing business with foreign entities establish some kind of a pattern so that you can go fearlessly about the business of doing business. And I would be very interested in any comments you have. I thank you very much. Madam Chairman, I yield back the balance of my time.

Mrs. BIGGERT. Thank you. And with that, I would like to thank this wonderful panel for being here. Your expertise has been very helpful to us and as we move forward with this legislation and the markup. With that, the Chair notes that some members may have additional questions—I think we really got through an awful lot of questions today—but for this panel, which they may submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

With that, the hearing is adjourned.

[Whereupon, at 12:13 p.m., the subcommittee was adjourned.]

A P P E N D I X

October 18, 2005

OPENING STATEMENT OF
CHAIRMAN SPENCER BACHUS
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
"H.R. 3505, FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2005"
OCTOBER 18, 2005

Good morning. Today's hearing will focus on H.R. 3505, the "Financial Services Regulatory Relief Act of 2005", which alters or eliminates unduly burdensome or outdated regulatory requirements. Introduced by Congressman Hensarling and Congressman Moore in July, H.R. 3505 – which I cosponsored – seeks to reduce the regulatory burden on insured depository institutions to benefit consumers and the economy by lowering costs and improving productivity.

This legislative hearing follows three earlier hearings on regulatory relief where we repeatedly heard the need for Congress to act to eliminate unnecessary regulations. Last month, we received recommendations on H.R. 3505 from the regulators. Today, we will hear from representatives of the financial services industry including Nevada Federal Credit Union President and CEO Bradley W. Beal on behalf of the National Association of Federal Credit Unions; Bank of Smithtown (NY) Chairman, President and CEO Bradley E. Rock on behalf of the American Bankers Association; National Bankers Association President Norma Alexander Hart; Superior Federal Credit Union of Lima, Ohio, CEO Phillip R. Buell on behalf of the Credit Union National Association; and Independent Community Bankers of America Chairman David Hayes. I look forward to hearing from today's

witnesses and thank them for taking time from their busy schedules to join us.

Under Chairman Oxley's leadership, this Committee has been dedicated to freeing depository institutions from unduly burdensome regulations so that they can more effectively meet the credit needs of their communities. During the 108th Congress, the Committee produced a comprehensive regulatory relief bill — H.R. 1375 — that passed the House by a margin of 392-25. Unfortunately, the Senate took no action. H.R. 3505 draws from and supplements the provisions of last Congress's bill. Additionally, it includes provisions from legislation sponsored by Mr. Ryun — H.R. 2061, the Community Banks Serving Their Communities First Act — and legislation sponsored by Mr. Royce and Mr. Kanjorski — H.R. 2317, the Credit Union Regulatory Improvements Act (CURIA). I applaud the goals of these bills which would allow banks and credit unions to devote more resources to the business of lending to consumers and less to the bureaucratic maze of compliance with outdated and unneeded regulations.

Let me close by commending Congressman Hensarling, Congressman Moore, Chairman Oxley, Ranking Member Frank and Ranking Member Sanders for their tireless efforts on this important piece of legislation. I look forward to working with them and the rest of the Members of this Committee as we move toward a markup and Floor consideration in the coming weeks.

I am now pleased to recognize the Ranking Member, Mr. Sanders, for an opening statement.

Congresswoman Julia Carson
Opening Statement
Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit
Tuesday, October 18, 2005

Mr. Chairman, I thank you for convening this hearing today to discuss the regulatory relief bill that this committee has been considering.

As we have been hearing in the past subcommittee hearings, the Federal Reserve Board estimates that the banking industry spends about $36 billion to comply with regulatory requirements at both the Federal and State levels. While many regulations are in place to ensure consumer safety and enforce compliance with various consumer protection statutes, some do prevent banks from effectively serving the public and drive up costs of doing business.

Our job, as a committee, is to make sure that we find a balance between protecting the American people's financial interests and regulation on credit unions, banks and other financial institutions to ensure effectiveness. These hearings have been a great help to this committee to find that balance.

I look forward to hearing from today's panel on what they believe should be done in this committee and by Congress to continue the effort to help them operate more efficiently. Thank you Mr. Chairman once again for holding this hearing.

Opening Statement

Congressman Paul E. Gillmor (R-OH)

Subcommittee on Financial Institutions and Consumer Credit

October 18, 2005

Hearing entitled: *"H.R. 3505, Financial Services Regulatory Relief Act of 2005"*

I want to thank Chairman Bachus for calling this hearing today. There is no doubt that our financial regulatory structure has contributed to the United States becoming the model for the world when it comes to financial services, but without constant attention to the burdens of outdated rules and regulations, the markets can be dragged down by unnecessary costs. Last Congress, the House passed H.R. 1375 with bipartisan support and it is my hope that in the 109th Congress, our Committee will again pass measures to provide regulatory relief to our banks, thrifts and credit unions.

Much of the problem with the current regulatory structure is that small banks are treated as large banks in a "one-size-fits-all" approach. Whether it is provisions of the USA-Patriot Act or Sarbanes-Oxley mandated internal control standards, small banks have faced enormous, and perhaps unnecessary, new cost in complying with these cumbersome regulations.

I am pleased to see that the Hensarling bill incorporates my compromise with Ranking Member Frank regarding so called industrial loan companies, or ILCs. It remains my belief that these institutions need to be reigned in and that the historic wall separating banking from commerce must remain intact. I am aware that not all ILC parent companies are supportive of our efforts to reduce the powers of the industrial loan charter, but requiring them to fit a Gramm-Leach-Bliley type test for *de novo* branching privileges is modest reform.

I look forward to working with Chairman Oxley and Chairman Bachus in again passing regulatory relief measures so that our depository institutions may remain the most efficient in the world.

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Subcommittee on Financial Institutions and Consumer Credit
Hearing on H.R. 3505 – Financial Services Regulatory Relief Act of 2005
October 18, 2005

Opening Statement
Rep. Bob Ney

I would like to thank Chairman Bachus for holding this important hearing today and for allowing me to participate.

I am very interested today to hear from the panel of witnesses regarding the regulatory relief needs of the financial services industry, particularly those of smaller institutions.

I am a strong supporter of efforts to relieve undue regulatory burdens on our nation's banks, thrifts and credit unions.

These institutions serve a vital role in our local communities and local economies.

The more these institutions are overly and unduly burdened by outdated or unnecessary regulatory requirements, the less able they are to effectively and efficiently serve their customers.

This harms not only the institutions, but ultimately and importantly, their customers and the communities they serve.

I look forward to supporting this effort as this bill moves forward and I look forward to hearing from the witnesses today.

Again, thank you Chairman Bachus for allowing me to sit in today.

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Testimony of

Bradley Beal

President/CEO of Nevada Federal Credit Union

On behalf of
The National Association of Federal Credit Unions

H.R. 3505, the "Financial Services Regulatory Relief Act of 2005"

Before the

House Financial Services Subcommittee on Financial Institutions and Consumer Credit
United State House of Representatives

October 18, 2005

Introduction

The National Association of Federal Credit Unions (NAFCU) is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of almost 800 federal credit unions—member owned financial institutions across the nation—representing nearly 26 million individual credit union members. NAFCU–member credit unions collectively account for approximately two-thirds of the assets of all federal credit unions. NAFCU and the entire credit union community appreciate this opportunity to participate in this discussion regarding regulatory relief for America's financial institutions. NAFCU supports H.R. 3505 as it would provide much needed relief to federal credit unions. NAFCU, however, suggests some modifications to the current legislation.

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created and has been recognized as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have no access to financial services. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions fill today for over 87 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)). While over 70 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two

fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain totally committed to providing their members with efficient, low cost personal service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's 8,945 federally insured credit unions serve a different purpose and have a fundamentally different structure, existing solely for the purpose of providing financial services to their members. In the seven years since Congress passed the *Credit Union Membership Access Act* (CUMAA – P.L. 105-219) federal credit unions have added almost 1,000 underserved areas resulting in low cost financial services being made available to over 87 million people. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions have an unparalleled safety and soundness record. Unlike banks and thrifts, credit unions have never cost the American taxpayer a single dime. While the Federal Deposit

Insurance Corporation (FDIC) and the Federal Savings and Loans Insurance Corporation (FSLIC) were both started with seed money from the United States Treasury, every dollar that has ever gone into the National Credit Union Share Insurance Fund (NCUSIF) has come from the credit unions it insures. Furthermore, unlike the thrift insurance fund that unfortunately cost hundreds of billions of dollars, credit unions have never needed a federal bailout.

I currently serve as the President and CEO of Nevada Federal Union headquartered in Las Vegas, Nevada, a position I have held since 1990. Nevada Federal Credit Union was formed in 1983 when two smaller credit unions – Nellis Southern Nevada FCU and Las Vegas FCU – merged. Nevada FCU has approximately 82,000 members and more than $840 million in assets.

I also presently serve as a member of the Board of Directors of the National Association of Federal Credit Unions and am the Board Secretary. I have previously served on NAFCU's Regulatory Committee, Federal Charter Enhancement Task Force, and Alternative Capital Task Force. Prior to joining Nevada FCU, I served as President of Nevada State Employees FCU in Carson City, Nevada and was the Senior Vice President of the Bank of Utah in Ogden, Utah. I am a licensed CPA in Nevada and am a member of the American Institute of Certified Public Accountants and the Nevada CPA Society.

Looking Beyond CUMAA

Credit unions have been the target of criticism by some in the banking industry for more than two decades. Over the past several years, the banker attacks have only intensified. The Supreme

Court's decision in 1998 in the AT&T Family Federal Credit Union field of membership case followed by Congress' prompt passage of CUMAA in the summer of 1998, which was seen by many as a significant victory for credit unions, brought the issue to the forefront. CUMMA overturned in eight short months a decision that had encompassed eight years of costly litigation initiated by the banks.

CUMAA was a necessary piece of legislation for credit unions at the time of its enactment because it codified a number of fundamental credit union concepts embraced by both federal and state-chartered credit unions. These include:

- the multiple-group policy that NCUA had initiated in 1984;
- the "once a member, always a member" principle followed by virtually every credit union in the country; and,
- the "family member" concept followed by many credit unions.

Yet CUMAA came with some provisions that were added in haste and not widely supported by the credit union community. These include:

- arbitrary limitations on member business loans;
- imposition of a bank-like Prompt Corrective Action (PCA) requirement that, given the structure of credit unions, serves in many respects as an overly restrictive constraint on growth; and
- various other artificial and arbitrary limitations on growth.

Following the passage of CUMAA, NAFCU recognized the need for additional credit union legislation. As a result, NAFCU convened a task force of federal credit unions and former federal credit unions (that had either converted to a state chartered credit union or mutual savings bank) to begin work on developing well-reasoned proposals to enhance the federal credit union charter and ease the regulatory burdens of all credit unions.

This group met to discuss its concerns related to the federal charter in the post-CUMAA environment. Below are highlights of some of the comments NAFCU heard at the session and in subsequent meetings:

- NCUA should work to eliminate unnecessary regulations and work with Congress to repeal laws which are only serving to drive small financial institutions out of business.
- Mergers seem to be a practical and necessary way of creating financially viable credit unions that can survive in today's financial services marketplace.
- It is important that the regulatory environment allow for credit union growth and not impair the ability of credit unions to remain competitive.

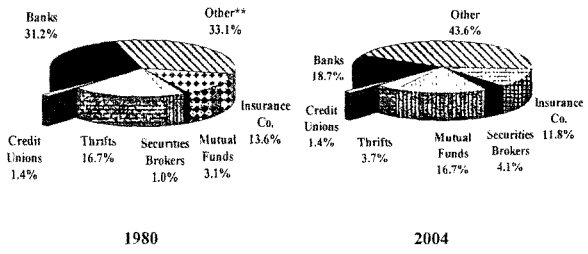
As a result of these meetings, it became clear that both regulatory and legislative action was needed in the post-CUMAA environment.

The Current Situation

NAFCU is pleased to report to the Committee that credit unions today are vibrant and healthy. Membership in credit unions continues to grow with credit unions serving over 87 million

Americans—more than at any time in history. At the same time, it is important to note that over the past 24 years, the credit union market share, as a percentage of financial assets, has not changed and, as a consequence, credit unions provide little competitive threat to other financial institutions. According to data obtained from the Federal Reserve Board, during the 24 year period from 1980 to 2004 the percentage of total financial assets held by credit unions remained constant at only 1.4%.

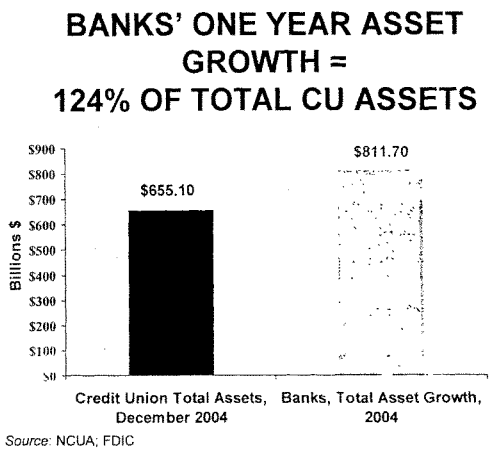
FINANCIAL ASSETS



**Other includes items such as private pension funds, mortgages, asset-backed securities, finance companies, and investments in bank personal trusts.

Source: Flow of Funds Accounts of the United States, FRB

The above chart only tells part of the story. Credit unions remain small financial institutions. Today, the average credit union has $71 million in assets, while the "average" bank and thrift has over $1 billion in assets.



Source: NCUA; FDIC

Furthermore, a number of individual banks have total assets greater than the entire credit union community combined. As shown in the chart above, the annual asset growth of the commercial bank sector last year exceeded the size of the entire credit union community, i.e. total assets—with banks growing in just one year by a magnitude that it took credit unions nearly a century to achieve.

As is the case with the banks and thrifts, there has been consolidation within the credit union community in recent years. The number of credit unions has declined by more than 61 percent over the course of the past 30 years, from an all-time high of 23,866 in 1969 to 8,945 this past March. Similar to the experience of all credit unions, the number of federal credit unions has declined by just about 56 percent over that same period, from a high of 12,921 in 1969 to 5,534 today.

NAFCU Meets with Policymakers to Enhance the Federal Charter

Over the past five years NAFCU has been working with former NCUA Board Chairman Dennis Dollar, current NCUA Board Chairman JoAnn Johnson, former Board Member Deborah Matz and their respective staffs in an effort to improve the regulatory environment for federal credit unions. We are pleased to see that these efforts have been productive in several respects.

On the legislative front, NAFCU has been meeting with legislators on both sides of the aisle to compile a package of initiatives to help credit unions better serve their members in today's sophisticated financial marketplace. An important part of that effort has involved identifying areas in which we believe Congress should provide what is now overdue regulatory relief. NAFCU has suggested a series of recommendations designed to enhance the federal charter, several of which were contained either in whole or in part in previous regulatory relief measures passed by the House. Credit unions exist in a very dynamic environment where the laws and regulations dealing with credit union issues are currently in need of review and refinement in order to ensure credit unions can continue to respond to changing market conditions.

Regulatory Relief Provisions

NAFCU supports the following 13 provisions, all of which are included in both Title III of the *Financial Services Regulatory Relief Act of 2005*, H.R. 3505, and in the *Credit Union Regulatory Improvements Act of 2005* (CURIA), H.R. 2317.

Sec. 302 - Leases of land on federal facilities for credit unions

NAFCU supports the effort to give credit unions the opportunity to negotiate land leases on federal property under the same terms and conditions as credit unions now able to lease space in federal buildings under the *Federal Credit Union Act* (FCUA). The credit unions that will be impacted by this change are predominantly defense (military) credit unions that have tried to expand their service to our men and women in uniform by building (and paying for) their own member service centers on military facilities. Many credit unions that have expanded their services by building their own facilities to serve military personnel have had their leases go from a nominal fee (e.g. $1.00 a year) to a "fair market value" rate of over $2,000 a month. For non-profit cooperative credit unions, this change in leasing costs will inevitably lead to higher fees and/or fewer services for the men and women they serve.

Sec. 303 - Investments in securities by federal credit unions

NAFCU supports this effort to increase investment options for federal credit unions by allowing certain limited investments in securities. The current limitations in the FCUA unduly restrict federal credit unions in today's dynamic financial marketplace and have the potential of adversely impacting both safety and soundness in the future. The track record of safe and sound performance by credit unions warrants expanded investment authority in accordance with regulations promulgated by the NCUA Board.

Sec. 304 - Increase in general 12-year limitation of term of federal credit union loans

NAFCU supports this provision that would increase the general 12-year limit on federal credit union loans to 15 years or longer as permitted by the NCUA Board. The current 12-year limit is

outdated and does not conform to maturities that are commonly accepted in the market today. We believe that it is also important that the NCUA Board have the discretionary authority to extend this limitation beyond 15 years when necessary in order to appropriately address marketplace conditions.

Sec. 305 - Increase in one-percent investment limit in credit union service organizations

NAFCU supports this provision to increase the one percent investment limit in credit union service organizations (CUSOs). However, in lieu of just raising the limit to three percent, as found in the last version of regulatory relief passed by the House, NAFCU recommends that Congress give the NCUA Board authority to establish an appropriate investment limit recognizing that as time goes on, that limit may warrant further adjustment.

Sec. 306 - Member business loan exclusion for loans to non-profit religious organizations

NAFCU supports this effort to exclude loans or loan participations by federally-insured credit unions to non-profit religious organizations from the member business loan limit.

Sec. 307 - Check-cashing and money-transfer services offered to those within the credit union's field of membership

NAFCU supports efforts to allow federal credit unions to offer check-cashing and money-transfer services to anyone within the credit union's field of membership. We believe this new authority, which would be discretionary and not mandatory, will allow credit unions to help combat abuses by non-traditional financial institutions that prey on our nation's immigrants and

others who live and work in underserved communities. The House passed stand-alone legislation to this effect (H.R. 749) on April 26, 2005.

Sec. 308 - Voluntary mergers involving certain credit unions

NAFCU supports this clarifying amendment since there is no sound reason for imposing a numerical limitation of 3,000 on the size of a group that can go forward with a credit union merger before considering spinning off the group and requiring it to form a separate credit union. In addition, the retroactive effective date of August 7, 1998 (the date of enactment of CUMAA), is an important part of this section and must be maintained.

Sec. 309 - Conversion of certain credit unions to community charter

NAFCU supports efforts that give NCUA the authority to allow credit unions to continue to serve and add members from their select employee groups (SEG's) after a credit union converts to a community charter. In addition, a credit union that converts to (or merges into) a community charter should be allowed to retain all employee groups in its field of membership at the time of conversion. Current law does not allow this, penalizing not only the credit union, but also those in its field of membership.

Sec. 310 - Credit union governance

The *Federal Credit Union Act* contains many antiquated "governance" provisions that, while perhaps appropriate in 1934, are outdated, unnecessary and inappropriate restrictions on the day-to-day operations and policies of a 21st century federal credit union. We support changes that would remove many of these provisions from the *Federal Credit Union Act* and allow the NCUA

to use its regulatory authority to address these issues in the future. For example, one antiquated provision prohibits credit unions from expelling disruptive or threatening members without a two-thirds vote of the membership; we believe the regulator and the credit union board should have some discretion in such cases. Additionally, NAFCU supports the following credit union governance proposals which would:

- allow credit unions to limit the length of service of members of the board of directors to ensure broader representation; and
- allow credit unions to reimburse volunteers on the board of directors for wages they would otherwise forfeit by participating in credit union-related activities.

Sec. 311 - Provide NCUA with greater flexibility in responding to market conditions

NAFCU supports the proposal to give NCUA the authority to adjust interest rates depending on market conditions. Under current law, federal credit unions are the only type of insured institutions subject to federal usury limits on consumer loans. This provision would still keep that limit, but give NCUA greater flexibility to make adjustments based on market conditions.

Sec. 312 - Exemption from pre-merger notification requirement of the Clayton Act

NAFCU supports the inclusion of this language which would exempt credit unions, just as banks and thrifts are already exempt, from the pre-merger notification requirements of the *Hart-Scott-Rodino Act*.

Sec. 313 - Treatment of credit unions as depository institutions under securities laws

Gramm-Leach-Bliley provided banks with registration relief from certain enumerated activities. NAFCU supports providing credit unions regulatory relief along those same lines, eliminating the requirement that credit unions register with the Securities and Exchange Commission (SEC) as broker/dealers when engaging in certain activities.

Sec. 314 - Modify the statutory definition of "net worth" to include the retained earnings from other institutions that have merged with the surviving credit union

Currently, credit union mergers are accounted for by using the "pooling method," meaning that the net worth of each merging credit union is combined to form the net worth of the surviving credit union: $2M (net worth of credit union A) + $2M (net worth of credit union B) = $4M (net worth of credit union AB). However, the Financial Accounting Standards Board (FASB) has proposed eliminating pooling and imposing the "purchase method" of accounting on credit union mergers. Using this method and the current definition of net worth which is "retained earnings" as required by PCA, the net worth of the surviving credit union is only $2M ($2M (net worth of credit union A) + $2M (net worth of credit union B) = $2M (net worth of credit union AB)). Therefore, under the purchase method of accounting, only the surviving credit union's retained earnings count as net worth for PCA purposes. Consequently, the surviving credit union may have trouble meeting PCA requirements, unless credit union net worth is redefined. It is important to note that this amendment does not legislate accounting practices; credit unions will be required to use the "purchase method" of accounting for mergers in order to receive a clean audit. This amendment does not grant credit unions that currently lack the authority to offer alternative capital accounts the authority to do so, nor does it confer upon NCUA the regulatory

authority or discretion to authorize such accounts now or in the future. This amendment, sought and supported by NAFCU, is intended to address a narrow and technical accounting issue and in the process simply maintain the status quo so that, in the case of merging credit unions, 2 + 2 can continue to equal 4.

At a House Subcommittee on Financial Institutions and Consumer Credit hearing on *The Net Worth Amendment for Credit Unions Act,* H.R. 1042, this past April, the Subcommittee heard support for the legislation from NCUA and the National Association of State Credit Union Supervisors (NASCUS). Additionally, Mr. Robert Herz, the Chairman of FASB, testified at the hearing that the legislation does not pose an issue to FASB's standard setting activities. The House passed H.R. 1042 under suspension of the rules on June 13, 2005.

Additionally, NAFCU supports the efforts in Title VII of H.R. 3505 to provide needed Bank Secrecy Act relief to financial institutions, including credit unions.

There are additional provisions NAFCU supports that are included in CURIA but which were not incorporated in the *Financial Services Regulatory Relief Act of 2005*, H.R. 3505. NAFCU encourages the Committee to review Title I of CURIA, which contains a provision that would alter net worth requirements for PCA purpose. NAFCU also recommends that the Committee consider the provisions on member business lending and credit union leasing opportunities in underserved areas that are included in Title II of CURIA.

Risk-based capital/PCA Reform

NAFCU supports this effort to modernize credit union capital requirements by redefining the net worth ratio to include risk assets. This would result in a new, more appropriate measurement to determine the relative risk of a credit union's assets and improve the safety and soundness of credit unions and the NCUSIF. We urge inclusion of the proposal put forth by the NCUA and included as Title I of the CURIA bill in any regulatory relief legislation.

It should be noted that the current capital system treats a new one-year unsecured $10,000 loan the same as a 30-year mortgage that is on its last year of repayment —something that simply does not make sense.

The American Bankers Association (ABA) expressed three concerns regarding risk-based capital in a letter to NCUA dated November 18, 2004. Specifically, the ABA said that:

(1) CUs need a meaningful leverage ratio;

(2) There should be no substantive difference between bank and CU leverage ratio standards; and,

(3) Secondary capital would undermine the unique character of credit unions.

We believe that these concerns have been addressed in the actual proposal transmitted to Capitol Hill and incorporated into Title I of CURIA. Neither the NCUA proposal nor Title I of CURIA would expand the authority for NCUA to authorize secondary capital accounts. As far as leverage ratios are concerned, NCUA's proposal:

- Advocates a system involving complementary leverage and risk-based standards working in tandem;

- For the leverage requirement, NCUA advocates a reduction in the standard net worth (i.e., leverage) ratio requirements for credit unions ***to a level comparable to what is required of FDIC insured institutions***. In order to achieve comparability between the federal insurance funds, it is necessary to factor in the NCUSIF's deposit-based funding mechanism; and
- The risk-based proposal tailors the risk-asset categories and weights of BASEL II, as well as related aspects of the FDIC's PCA system, to the operation of credit unions. This approach is consistent with BASEL II and the FDIC's PCA system, addressing credit and operational risks under the risk-based requirement and acknowledging other forms of risk, such as interest rate risk.

The ABA's letter of November 18, 2004, also reiterates the recommendation contained in its April 18, 2000, comment letter to NCUA that said:

> "NCUA should adopt a more bank-like risk-weighted capital system and then work with the banking agencies within the umbrella of the Federal Financial Institutions Examination Council to improve the current risk-based capital adequacy standard to better recognize credit quality and the use of internal risk models to manage financial institution risk."

What NCUA has transmitted to policy-makers on Capitol Hill (which is included in CURIA), in fact, closely resembles the bank-like risk-weighted capital system, and was developed with ample input from the Treasury Department. One difference, however, is that NCUA's proposal does not consider any credit union "internal risk models." While NCUA may in the future make that part of the risk mitigation credit, we have no assurance that this will be the case, so one

could objectively conclude that the proposed risk-base capital system for credit unions is, in fact, more stringent than that currently applicable to banks and thrifts.

Limits on member business loans

NAFCU supports elimination of the current asset limit on member business loans at a credit union from the lesser of 1.75 times actual net worth or 1.75 times net worth required for a well-capitalized credit union, and replacing it with a flat rate of 20 percent of the total assets of a credit union, as proposed in Title II of CURIA. NAFCU believes this provision would facilitate member business lending without jeopardizing the safety and soundness of participating credit unions. While the current cap was first imposed on credit unions as part of CUMAA in 1998, the law also directed the Treasury Department to study the need for such a cap. In 2001, the Treasury Department released its study entitled "Credit Union Member Business Lending" in which it concluded that "credit unions' business lending currently has no effect on the viability and profitability of other insured depository institutions." We would urge the Committee to review this study and give it the weight it deserves when considering these provisions. NAFCU also supports revising the current definition of a member business loan by giving the NCUA the authority to exclude loans of $100,000 or less as de minimus, rather than preserving the current threshold of $50,000. Such action would serve to benefit America's small businesses.

Leasing space in buildings with credit union offices in underserved areas

NAFCU supports the provision in CURIA that enhances the ability of credit unions to assist distressed communities with their economic revitalization efforts. It would allow a credit union to lease space in a building or on property in an underserved area in which it maintains a physical

presence to other parties on a more permanent basis. It would permit a federal credit union to acquire, construct, or refurbish a building in an underserved community, and lease out excess space in that building.

Conclusion

NAFCU believes that the state of the credit union community is strong and the safety and soundness of credit unions is unquestionable. Nevertheless, there is a clear need for easing the regulatory burden on credit unions as we move forward into the 21st century financial services marketplace. Providing credit unions some relief from the regulatory burdens that they face will allow credit unions to better serve their members and meet their needs in a dynamic marketplace. NAFCU fully supports H.R. 3505. However, NAFCU still urges the Committee to consider the important provisions included in CURIA as possible amendments to H.R. 3505. We understand that this legislation is a work in progress and we urge you to undertake careful examination of any other measures that fall within the scope of this legislation. We look forward to working with you on this important matter and would welcome your comments or questions.

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WRITTEN TESTIMONY
OF
PHILLIP BUELL
PRESIDENT & CEO, SUPERIOR FEDERAL CREDIT UNION
ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION
ON
"H.R. 3505, THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2005"
BEFORE THE
HOUSE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
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October 18, 2005

Chairman Bachus, Ranking Member Sanders, and other members of the Subcommittee, on behalf of the Credit Union National Association (CUNA), I appreciate this opportunity to come before you and express the association's views on H.R. 3505, the Financial Services Regulatory Relief Act of 2005. We congratulate Reps. Hensarling and Moore for the introduction of this important bill, and thank the Subcommittee for its continued commitment to alleviating the unnecessary paperwork and other burdens that interfere with the delivery of financial services to the nation's consumers.

CUNA is the largest credit union advocacy organization, representing over 90% of our nation's approximately 9,000 state and federal credit unions and their 87 million members.

I am Phil Buell, President & CEO of Superior Federal Credit union. Superior is $174 million credit union with 32,000 members, serving the West Ohio Region, including 3 of 6 offices located in underserved communities.

CUNA is especially pleased that the Subcommittee is continuing its efforts to provide regulatory relief of unneeded and costly burdens. Some might suggest that the Credit Union Membership Access of 1998[1] (CUMAA) was the credit union version of regulatory relief. While that law did provide relief from an onerous Supreme Court decision, it also imposed several new, stringent regulations on credit unions, which, in spite of assertions to the contrary, are the most stringently regulated of insured financial institutions.

Credit Unions Are Distinct Financial Institutions

Among its numerous provisions, the CUMAA required the U.S. Department of the Treasury to evaluate the differences between credit unions and other types of federally insured financial institutions, including any differences in the regulation of credit unions and banks.

The study, "Comparing Credit Unions with Other Depository Institutions," found that while "credit unions have certain characteristics in common with banks and thrifts, (e.g., the intermediation function), they are clearly distinguishable from these other depository institutions in their structure and operational characteristics."

[1] Pub. L. No. 105-219 Sec. 401; 112 Stat. 913 (1998); 12 USC 1752a note and 1757a note

These qualities, catalogued by the U.S. Treasury in its 2001 study, had been previously incorporated into the congressional findings of the Federal Credit Union Act[2] when CUMAA was adopted in 1998.

Recognition and appreciation of such attributes is critical to the understanding of credit unions, as Congress made it clear when it amended the Federal Credit Union Act in 1998 that it is these characteristics that form the foundation on which the federal tax exemption for credit unions rests. As Congress determined when it passed CUMAA:

"Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are:

1. member-owned,
2. democratically operated,
3. not-for profit organizations,
4. generally managed by volunteer boards of directors, and
5. because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means."

While other institutions, such as mutual thrifts, may meet one or two of these standards or display some of these differences, other credit union distinctions listed here do not necessarily apply. As Treasury noted in its study, "Many banks or thrifts exhibit one or more of ...(these) characteristics, but only credit unions exhibit all five together." [3]

Other 1998 congressional findings in the Federal Credit Union Act also emphasize the unique nature of credit unions:

(1) "The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means.
(2) "Credit unions continue to fulfill this public purpose and current members and membership groups should not face divestiture from the financial services institution of their choice as a result of recent court action.

Since their inception, credit unions continue to share these unique attributes, separating them from other depository institutions. Despite the frequent attempts of detractors to present credit unions in a false light and label them as other types of institutions, the distinct characteristics of credit unions have been recognized in statute and in analytical reports from the U.S. Treasury and others. Further, despite repeated attempts, legal challenges brought by banking groups against the National Credit Union Administration's (NCUA) field of membership policies under CUMAA have not proved fruitful.

As unique institutions, credit unions today stand distinctly in need of regulatory relief.

Credit Unions' Regulatory Burden Is *Real* And Relief Is Imperative

As cooperative financial institutions, credit unions have not been shielded from the mounting regulatory responsibilities facing insured depositories in this country.

[2] P. L. 105-219, Sec. 2, 112 Stat. 913
[3] U.S. Dept. of the Treasury, *Comparing Credit Unions with Other Depository Institutions, (Wash. DC: 2001.)*

Last year, Federal Deposit Insurance Corporation (FDIC) Vice Chairman John M. Reich said in testimony before the House Subcommittee on Financial Institutions and Consumer Credit, "regulatory burden is a problem for all banks." His statement is accurate as far as it goes.

Regulatory burden is an issue for all financial institutions generally, and credit unions in particular. Indeed, credit unions **are the most heavily regulated of all financial institutions.** This dubious distinction is the result of several factors, which include:

- Credit unions operate under virtually the same consumer protection rules, such as Truth-Lending, Equal Credit Opportunity, Home Mortgage Disclosure, Real Estate Settlement Procedures Act, Truth-in-Savings, Expedited Funds Availability Act, USA Patriot Act, Bank Secrecy, safety and soundness including prompt corrective action (PCA) regulations reviewed by Treasury, and other rules that apply to banks. Credit unions will also have to comply with developing rules under the Fair and Accurate Credit Transactions (FACT) Act and the Check 21 statutory requirements. A list of the 137 rules that federal credit unions must follow is attached.

  In addition:

  (1) Credit unions are the only type of financial institution that have restrictions on whom they may serve;
  (2) Credit unions are the only group of financial institutions that must comply with a federal usury ceiling;
  (3) Credit unions may not raise capital in the marketplace but must rely on retained earnings to build equity;
  (4) Credit unions are the only group of financial institutions that must meet statutory net worth requirements;
  (5) Credit unions face severe limitations on member business lending;
  (6) Credit unions have limitations on loan maturities;
  (7) Credit unions have stringent limitations on investments;
  (8) Credit unions have not been granted new statutory powers, as banks have under Gramm-Leach Bliley; and
  (9) Credit unions' operations and governance are inflexible because many aspects are fixed in statute.

Most importantly for credit unions, time and other resources spent on meeting regulatory requirements are resources that would otherwise be devoted to serving their members – which is, after all, their primary objective.

With Few Exceptions, Credit Unions Must Comply with Virtually All Bank Rules

Despite unfounded banker charges to the contrary, federally insured credit unions bear an extraordinary regulatory burden that is comparable to that of banks in most areas and much more restrictive in others.

As the Treasury's 2001 study comparing credit unions with other institutions concluded, "Significant differences (in the general safety and soundness regulation of banks and credit unions,

parenthesis added) have existed in the past, but have been gradually disappearing." The Treasury study cited PCA and net worth requirements for credit unions as a major regulatory difference that was removed in 1998.

Treasury further noted that their "relative small size and restricted fields of membership" notwithstanding, "federally insured credit unions operate under bank statutes and rules virtually identical to those applicable to banks and thrifts."

Credit Unions Must Comply With Substantial Requirements Banks Don't Have to Follow

In addition to following rules applicable to the banking industry, credit unions operate under considerable statutory and regulatory requirements that do not apply to other types of financial institutions.

As Treasury's study pointed out, credit union statutory net worth requirements direct federally insured credit unions to maintain a minimum of 6% net worth to total assets in order to meet the definition of an adequately capitalized credit union. Well-capitalized credit unions must meet a 7% net worth ratio. "(T)his exceeds the 4% Tier 1 level ratio applicable for banks and thrifts (and is statutory as opposed to regulatory)," Treasury stated. Complex credit unions have additional net worth requirements.

Treasury's analysis also pointed to the fact that **"federal credit unions have more limited powers than national banks and federal saving associations. Most notably, federal credit unions face stricter limitations on their (member business)** ...lending and securities activities. In addition, a usury ceiling prevents them from charging more than 18% on any loan, and the term of many types of loans may not extend beyond twelve years."

Credit unions also have statutory and regulatory restrictions as to whom they may serve. Federal credit unions' fields of membership must meet the common bond requirements that apply to an associational, occupational, multi-group or community credit union. Thus, unlike banks and thrifts, which may serve anyone regardless of where they live or work, a credit union may only offer its services to individuals within its field of membership.

Credit unions operate under heavily constrained investment authority as well. A federal credit union may invest in government securities and other investments only as provided under the Federal Credit Union Act and authorized by NCUA.

Credit unions also must comply with limitations on lending, including member business lending. A federal credit unions' member business loan (MBL) may not exceed the lesser of 1.75 times its net worth or 12.25 percent of total assets, unless the credit union is chartered to make such loans, has a history of making such loans or has been designated as a community development credit union. By comparison, banks have no specific limits on commercial lending and thrifts may place up to 20% of their total assets in commercial loans.

It is useful to note that there are other limitations on credit unions' member business lending that do not apply to commercial banks. A credit union's MBLs must generally meet 12-year maturity limits and can only be made to members. Credit union MBLs have significant collateral and while not required, often carry the personal guarantee of the borrower.

Commercial banks have a variety of mechanisms through which they can raise funds, including through deposit-taking or borrowing funds in the capital markets. In marked contrast, credit unions may only build equity by retaining earnings. A credit union's retained earnings are collectively owned by all of the credit unions' members, as opposed to a bank that is owned by a limited number of stockholders or in some cases, by a finite number of individuals or family members.

Thus, a major distinction between credit unions and commercial banks is that credit unions operate under a number of specific, operational regulations that do not apply to banks. Bank trade associations attempt to mislead Congress when they erroneously argue that credit unions have evolved into banks. The restrictions on credit union operations and the limitations on their activities drive a stake into the heart of that argument.

Unlike Banks, Credit Unions Have Not Received New Statutory Powers

Not only have credit unions not received new statutory powers as banks have, severe regulatory constraints on member business lending and under PCA have been imposed on credit unions for the last several years.

An important study regarding the regulation of credit unions was published in 2003 under the auspices of the Filene Research Institute and addresses the regulatory advantages banks have over credit unions.

Authored by Associate Professor of Economics William E. Jackson, III, Kenan-Flagler Business School, University of North Carolina at Chapel Hill and entitled, "The Future of Credit Unions: Public Policy Issues,"[4] the study looked at the efforts of Congress over the last two decades to provide regulatory relief for traditional depository institutions and whether more relief for credit unions is reasonable and appropriate.

The study reviewed sources of funding, investments, and the ownership structure of banks, thrifts and credit unions and found that the operational differences among these types of institutions are "distinctive." It observed that since 1980, Congress has enacted a number of statutory provisions that have noticeably changed the regulatory environment in which banks and thrifts conduct business, such as by deregulating liabilities; removing restrictions on interstate branching; and expanding the list of activities permissible for financial holding companies.

For example, the Gramm-Leach-Bliley Act of 1999 expanded the statutory definition of the kinds of products and services in which banks may engage. Under the Act, banking institutions may engage in activities that are merely "financial in nature" as opposed to those that are "closely related to banking." The bank regulators have the authority to determine what is permissible as "financial in nature." Credit unions were not included in this sweeping, statutory expansion of bank powers. However, while they received neither benefits nor new powers under the Gramm-Leach-Bliley Act, credit unions were included in the substantial requirements under the Act regarding privacy, including requirements to communicate their member privacy protection policies to members on an annual basis.

[4] Jackson, III, William E., University of North Carolina-Chapel Hill. ***The Future of Credit Unions: Public Policy Issues, 2003.***

The credit union study noted, "Credit unions face stricter limitations on their lending and investing activities" than other institutions bear. "In general, credit unions have received less deregulation than either banks or thrifts," the study concluded.

Pending Credit Union Regulatory Improvements Legislation That CUNA Supports
Before discussing H.R. 3505, I want to make sure your are aware that CUNA strongly supports H.R. 2317, the Credit Union Regulatory Improvements Act (CURIA), which was recently introduced by Representatives Royce and Kanjorski.

In our view, both of these bills provide an excellent starting point for the House Financial Institutions Subcommittee as it considers real reforms that will provide regulatory relief to credit unions and other institutions.

While CUNA also supports other statutory changes, we first want to focus on amendments to the Federal Credit Union Act that are contained in H.R. 2317.

H.R. 2317—The Credit Union Regulatory Improvements Act
Although this legislation goes beyond what is included in H.R. 3505, it nevertheless provides a sound foundation for this Subcommittee's consideration of some fundamental problems facing credit unions today and we ask you to take a close look at these proposed changes as incorporated in CURIA. This portion of my testimony will describe the different sections of CURIA, followed by an explanation of why CUNA strongly supports the proposed and necessary changes.

H.R. 2317, THE CREDIT UNION REGULATORY IMPROVEMENTS ACT OF 2005--SECTION-BY-SECTION DESCRIPTION

TITLE I: CAPITAL REFORM

CUNA strongly supports this title, which reforms the system of PCA for credit unions by establishing a dual ratio requirement: a pure leverage ratio and a net worth to risk-asset ratio. The resulting system would be comparable to the system of PCA in effect for FDIC insured institutions while taking into account the unique operating characteristics of cooperative credit unions.

Section 101. Amendments to Net Worth Categories
The Federal Credit Union Act specifies net worth ratios that, along with a risk-based net worth requirement, determine a credit union's net worth category. This section would continue to specify net worth requirements, but at levels more appropriate for credit unions and comparable to those currently in effect for banking institutions.

Section 102. Amendments Relating to Risk-Based Net Worth Categories
Currently, federally insured credit unions that are considered "complex" must meet a risk-based net worth requirement. This section would require all credit unions to meet a risk-based net worth requirement, and directs the NCUA Board to design the risk-based requirement appropriate to credit unions in a manner more comparable to risk standards for FDIC-insured institutions.

Section 103. Treatment Based on Other Criteria
Current risk-based net worth requirements for credit unions incorporate measures of interest-rate risk as well as credit risk. The comparable standards for risk-based capital requirements for FDIC insured institutions of Section 102 deal only with credit risk. This section would permit delegation to NCUA's regional directors the authority to lower by one level a credit union's net worth category for reasons of interest rate risk only that is not captured in the risk-based ratios.

Section 104. Definitions Relating to Net Worth
Net worth, for purposes of PCA, is currently defined as a credit union's retained earnings balance under generally accepted accounting principles. The Financial Accounting Standards Board (FASB) is finalizing guidance on the accounting treatment of mergers of cooperatives that would create a new component of net worth, in addition to retained earnings, after a credit union merger. The unintended effect of the FASB rule will be to no longer permit a continuing credit union to include the merging credit union's net worth in its PCA calculations. This section addresses that anomaly and defines net worth for purposes of PCA to include the new component for post-merger credit unions.

It was our understanding that FASB intended to apply the standard to credit unions beginning in early 2006, following a comment period, but now may be putting application of the standard off until the beginning of 2007. Such a change, we believe, will have the unintended consequence of discouraging, if not eliminating, voluntary mergers that, absent FASB's policy, would be advantageous to credit union members involved. In addition, FASB's application of its proposal to credit unions will mean that a credit union's net worth would typically be understated by the amount of the fair value of the merging credit union's retained earnings.

This result is not in the public interest. That is why CUNA, along with the NCUA and others, supports a technical correction that would amend the Federal Credit Union Act to make it clear that net worth equity, including acquired earnings of a merged credit union as determined under GAAP, and as authorized by the NCUA Board. Senior legal staff at FASB have indicated support for a legislative approach, and we urge the Subcommittee to likewise support such an effort, well in advance of the effective date so credit unions will have certainty regarding the accounting treatment of mergers.

Legislation was introduced by Representative Bachus to address this issue in H.R. 1042, the "Net Worth Amendment of Credit Unions Act," which received a hearing from this Subcommittee on April 13, 2005, and is pending further action. We are grateful to Chairman Bachus and members of the Full Committee for recognizing the importance and urgency of this matter. The correction of this issue is identical in H.R. 1042 and H.R. 2317.

Also in this section, the definition of secondary capital for low-income credit unions is expanded to include certain limitations on its use by those credit unions. The definition of the net worth ratio is modified to exclude a credit union's share insurance fund deposit from the numerator and denominator of the ratio, and the ratio of net worth to risk-assets is defined, also to exclude a credit union's share insurance fund deposit from the numerator.

Section 105. Amendments Relating to Net Worth Restoration Plans
Section 105 would provide the NCUA Board with the authority to permit a marginally undercapitalized credit union to operate without a net-worth restoration plan if the Board determines that the situation is growth-related and likely to be short term.

This section would also modify the required actions of the Board in the case of critically undercapitalized credit unions in several ways. First, it would authorize the Board to issue an order to a critically undercapitalized credit union. Second, the timing of the period before appointment of a liquidating agent could be shortened. Third, the section would clarify the coordination requirement with state officials in the case of state-chartered credit unions.

The following is a detailed discussion of the need for and logic of PCA reform.

HISTORY OF CREDIT UNION PCA

The PCA section of CUMAA established for the first time "capital" or "net worth" requirements for credit unions. Prior to that time, credit unions were subject to a requirement to add to their regular reserves, depending on the ratio of those reserves to "risk-assets" (then defined as loans and long-term investments). The purpose of Section 1790d (PCA) of the Act is "to resolve the problems of insured credit unions at the least possible long-term loss to the Fund." The CUMAA instructs the NCUA to implement regulations that establish a system of PCA for credit unions that is consistent with the PCA regime for banks and thrifts under the Federal Deposit Insurance Corporation Improvement Act (FDICIA) but that takes into account the unique cooperative nature of credit unions.

There are, however, a number of ways that credit union PCA under CUMAA differs from PCA as it applies to banks and thrifts under FDICIA. Chief among these is that the net worth levels that determine a credit union's net worth classification are specified in the Act rather than being established by regulation as is the case for banks and thrifts. Further, the levels of the net worth ratio for a credit union to be classified "well" or "adequately" capitalized are two percentage points (200 basis points) above those currently in place for banks and thrifts, even though credit unions' activities are far more circumscribed that those of banks. In addition, the system of risk-based net worth requirements for credit unions is structured very differently from the Basel-based system in place for banks and thrifts. For example, the Basel system is credit-risk based while credit union risk-based net worth requirements explicitly account for the difficult-to-quantify interest rate risk. In PCA as implemented under FDICIA, interest rate risk is instead dealt with through examination and supervision.

NEED FOR REFORM OF CREDIT UNION PCA

Net worth requirements were not the original purpose of the CUMAA. The genesis of the Act was the Supreme Court's field of membership decision of 1998 that prohibited NCUA from approving credit union fields of membership comprising more than one group. Since its adoption seven years ago, NCUA and credit unions have had sufficient time to experience PCA requirements. Therefore, it is not surprising that there should be a need for some modifications to PCA now that the NCUA and the credit union movement have been operating under PCA for several years.

There are two basic problems with the current PCA system.

- **HIGH BASIC CREDIT UNION CAPITAL REQUIREMENTS.** Credit unions have significantly higher capital requirements than do banks, even though the credit union National Credit Union Share Insurance Fund (NCUSIF) has an enviable record compared to other federal deposit insurance funds. Indeed, because credit unions' cooperative structure creates a systemic incentive against excessive risk taking, it has been argued that credit unions actually require less capital to meet potential losses than do other depository institutions.

- **RISK BASED SYSTEM IS IMPRECISE.** The current system of risk-based net worth requirements for credit unions provides an imprecise treatment of risk. It is only when a portfolio reaches a relatively high concentration of assets that it signals greater risk and the need for additional net worth. This unartful system weakens the measurement of the NCUSIF's exposure to risk, and provides blurred incentives to credit unions on how to arrange their balance sheets so as to minimize risk. A Basel-type method of applying different weights to asset types based on the asset's risk profile would permit a more precise accounting for risk than does the current credit union system, thus improving the flow of actionable information regarding net worth adequacy to both regulators and credit unions.

Taken together, these problems have created an unnecessary constraint on healthy, well-managed credit unions. Credit unions agree that any credit union with net worth ratios well below those required to be adequately capitalized should be subject to prompt and stringent corrective action. There is no desire to shield such credit unions from PCA; they are indeed the appropriate targets of PCA. Because credit unions themselves fund the NCUSIF, they are keenly aware that they are the ones that pay when a credit union fails. Therefore, CUNA strongly supports a rigorous safety and soundness regulatory regime for credit unions that is anchored by meaningful and appropriate net worth requirements that drive the credit union system's PCA requirements.

Under the current system of PCA, there are many credit unions that have more than enough capital to operate in a safe and sound manner, but that feel constrained in serving their members because potential reductions in their net worth category can result from growth in member deposits, even when uninduced by the credit union. The current law stipulates that a credit union with a 6% net worth ratio is "adequately" capitalized. Considering the risk exposure of the vast majority of credit unions and the history of their federal share insurance fund, 6% is more than adequate net worth. However, as a result of the effect of potential growth on a credit union's net worth ratio under the present system of PCA, a very well run, very healthy, very safe and sound credit union feels regulatory constraints operating with a 6% net worth ratio. Without access to external capital markets, credit unions may only rely on retained earnings to build net worth. Thus, a spurt of growth brought on by members' desire to save more at their credit union can quickly lower a credit union's net worth ratio, even if the credit union maintains a healthy net income rate.

We are not here describing credit unions that aggressively and imprudently go after growth, just for growth's sake. Rather, any credit union can be hit with sharp and unexpected increases in member deposits, which are the primary source of asset growth for credit unions. This can happen whenever credit union members face rising concerns either about their own economic or employment outlook (as in a recession) or about the safety of other financial investments they may hold (as when the

stock market falls). The resulting cautionary deposit building or flight to safely translates into large swings in deposit inflows without any additional effort by the credit union to attract deposits. As an example, total credit union savings growth rose from 6% in 2000 to over 15% in 2001 despite the fact that credit unions lowered deposit interest rates sharply throughout the year. The year 2001 produced both a recession and falling stock market, and was topped off with the consumer confidence weakening effects of September 11th.

Credit union concern about the impact of uninduced growth on net worth ratios goes far beyond those credit unions that are close to the 6% cutoff for being considered adequately capitalized. Again, because of the conservative management style that is the product of their cooperative structure, most credit unions wish always to be classified as "well" rather than "adequately" capitalized. In order to do that, they must maintain a significant cushion above the 7% level required to be "well" capitalized so as not to fall below 7% after a period of rapid growth. A typical target is to have a 200 basis point cushion above the 7% standard. Thus, in effect, the PCA regulation, which was intended to ensure that credit unions maintain a 6% adequately capitalized ratio, has created powerful incentives to induce credit unions to hold net worth ratios roughly 50% higher than that level, far in excess of the risk in their portfolios. The PCA regulation in its present form thus drives credit unions to operate at "overcapitalized" levels, reducing their ability to provide benefits to their members, and forcing them instead to earn unnecessarily high levels of net income to build and maintain net worth.

There are two ways to resolve these problems with the current system of PCA. One would be to permit credit unions to issue some form of secondary capital in a way that both provides additional protection to the NCUSIF and does not upset the unique cooperative ownership structure of credit unions. CUNA believes that credit unions should have greater access to such secondary capital. However, this bill does not provide access to secondary capital.

The other solution is reform of PCA requirements themselves. Reform of PCA should have two primary goals. First, CUNA believes any reform should preserve the requirement that regulators must take prompt and forceful supervisory actions against credit unions that become seriously undercapitalized, maintaining the very strong incentives for credit unions to avoid becoming undercapitalized. This is essential to achieving the purpose of minimizing losses to the NCUSIF. Second, a reformed PCA should not force well-capitalized credit unions to feel the need to establish a large buffer over minimum net worth requirements so that they become overcapitalized.

H.R. 2317 would reform PCA in a manner consistent with these two requirements by transforming the system into one with net worth requirements comparable to those in effect for FDIC insured institutions, and that is much more explicitly based on risk measurement by incorporating a Basel-type risk structure.

Under H.R. 2317, a credit union's PCA capitalization classification would be determined on the basis of two ratios: the net worth ratio and the ratio of net worth to risk assets. The net worth ratio would be defined as net worth less the credit union's deposit in the NCUSIF, divided by total assets less the NCUSIF deposit. The ratio of net worth to risk assets would be defined as net worth minus the NCUSIF deposit divided by risk assets, where risk assets would be designed in a manner comparable to the Basel system in effect for banks of similar size to credit unions. The tables below show the ratio cutoff points for the various net worth classifications. A credit union would have to meet both ratio classifications, and if different, the lower of the two classifications would apply.

For example, a credit union classified as "well capitalized" by its net worth ratio, but "undercapitalized" by its ratio of net worth to risk assets would be considered undercapitalized.

Net Worth Categories	Net Worth Ratio	Ratio of Net Worth to Risk Assets
Well Capitalized	5% or greater	8% or greater
Adequately Capitalized	4% to < 5%	8% or greater
Undercapitalized	3% to < 4%	6% to 8%
Signif. Undercapitalized	2% to < 3%	< 6%
Critically Undercapitalized	<2%	NA

The net worth cutoff points specified in H.R. 2317 are substantially similar to those currently in effect for FDIC insured institutions, yet, the ratios would have the effect of being more stringent on credit unions for two reasons. First, not all of an individual credit union's net worth is included in the numerator of the ratio; the NCUSIF deposit is first subtracted. Second, a portion of banks' net worth can be met by secondary or Tier II capital. All but low-income credit unions have no access to secondary capital, so all credit union net worth is equivalent to banks' Tier I capital, which has more characteristics of pure capital than does Tier II.

H.R. 2317 would require NCUA to design a risk-based net worth requirement based on comparable standards applied to FDIC insured institutions. The outlook for those standards as they will apply to banks is currently under review by the federal banking regulators. Federal banking regulators have indicated that when Basel II takes affect for the very largest U.S. banks (approximately 25 banks and thrifts), some modifications to Basel I for all other U.S. banks will be implemented.

The exact nature of the changes to Basel I for the vast bulk of U.S. banks and thrifts is as yet unclear, although U.S. banking regulators have stated they do not intend to permit smaller U.S. banks to be disadvantaged compared to the largest banks when Basel II lowers net worth requirements for the very large institutions. Thus, it will be the modified version of Basel I in place for smaller banks that will be the standard under which NCUA will construct a risk weighting system for credit unions. Since it will be Basel based, it will focus on credit risk, leaving the treatment of interest rate risk to the supervisory process. The new credit union risk-based system will provide a much more precise measure of balance sheet risk than the current risk-based net worth requirement.

H.R. 2317 will improve the risk-based components of PCA and place greater emphasis on the risk-based measures, while lowering to the same level in effect for banks, the pure net worth ratio requirements for a credit union to be classified as adequately capitalized. CUNA believes that in addition to relying on improved risk measurements, a reduction of the pure net worth levels to be classified as well- or adequately-capitalized is justified for the following reasons:

1. One of the original justifications for higher credit union PCA net worth requirements (higher than for banks) was the 1% NCUSIF deposit. While FASB and NCUA have both affirmed that the 1% NCUSIF deposit is an asset and thus part of net worth, as a result of the unique funding mechanism of the NCUSIF (it has been funded solely by credit unions), the 1% deposit appears on the books of both the NCUSIF and insured credit unions. H.R. 2317 has addressed this issue by defining the net worth ratio as net worth less the 1% NCUSIF deposit divided by assets less the 1%

deposit. Thus, to be adequately capitalized, a credit union must hold net worth equal to about 5.7% (on average) of its assets to meet the 5% net worth requirement. This means that the discretionary and mandatory supervisory actions of PCA will be applied at higher levels of individual credit union capitalization than for similarly situated banks and thrifts.

2. Another reason given for credit unions' higher net worth requirements is their lack of access to capital markets. Credit unions' only source of net worth is the retention of earnings, which is a time consuming process. The idea was that since credit unions cannot access capital markets, they should hold more capital to begin with so that they have it available in time of need. There is some merit to this notion, but a problem with this logic is that is suggests that a poorly capitalized bank can easily access the capital markets. However, if a bank's capital ratio falls substantially due to losses, investors are likely to be wary of providing additional capital to it. Other institutions similarly have limited access to capital markets when they have experienced substantial losses. Thus, the lack of effective access to outside capital in times of financial stress might not really distinguish credit unions from banks or other depository institutions as much as it might appear.

3. The other reason that a credit union's net worth ratio might fall – rapid asset growth – does not require higher net worth requirements for credit unions either. Asset growth (which comes from savings deposits) can be substantially influenced by a credit union's dividend policies. Under the current PCA system, lowering dividend rates creates the dual effects of retarding growth and boosting net income, both of which raise net worth ratios which would not occur had dividend rates been lowered. H.R. 2317 would permit a credit union to protect a reasonable net worth ratio with appropriate dividend rate cutting rather than being required to hold additional net worth.

There is substantial evidence that credit unions actually require **less** net worth than do for-profit financial institutions in order to provide protection to the deposit insurance system.[5] Credit unions, because of their very cooperative nature, take on less risk than do for-profit financial institutions. Because credit union boards and management are not enticed to act by stock ownership and options, the moral hazard problem of deposit insurance has much less room for play in credit unions than in other insured depository institutions. Evidence of the effects of this conservative financial management by credit unions is found in the fact that average credit union ratios for net worth, net income and credit quality have shown dramatically less volatility over that past two decades than comparable statistics for banks and thrifts. Similarly, the equity ratio of the NCUSIF has been remarkably stable, between 1.2% and 1.3%, of insured shares while other federal deposit funds have seen huge swings, and even insolvency. This is hardly evidence supporting the need of more capital in credit unions than in banks and thrifts.

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[5] See *The Federal Deposit Insurance Fund that Didn't Put a Bite on U.S.Taxpayers*, Edward J. Kane and Robert Hendershott, Journal of Banking and Finance, Volume 20, September 1996, pp.1305-1327. Kane and Hendershott summarize their paper as "the paper analyzes how differences in incentive structure constrain the attractiveness of interest-rate speculation and other risk-taking opportunities to managers and regulators of credit unions." See also *Differences in Bank and Credit Union Capital Needs*, David M. Smith and Stephen A. Woodbury (Filene Research Institute, Madison, WI. 2001) Smith and Woodbury find that credit unions have lower loan delinquencies and net-charge off rates than do banks, and that charge-offs at credit unions are only two-thirds as sensitive to macroeconomic shocks as they are at banks. They also explain that because of the governance structure in credit unions "economic theory predicts that credit unions would take less risk than banks." (p. 5)

Reforming PCA as provided in H.R. 2317 would preserve and strengthen the essential share-insurance fund protection of PCA and would more closely tie a credit union's net worth requirements to its exposure to risk – the reason for holding net worth in the first place. It would also permit adequately and well-capitalized credit unions to operate in a manner devoted more to member service and less to the unnecessary accumulation of net worth.

TITLE II: ECONOMIC GROWTH

Section 201. Limits on Member Business Loans
This section eliminates the current asset limit on MBLs at a credit union from the lesser of 1.75 times actual net worth or 1.75% times net worth required for a well-capitalized credit union and replaces it with a flat rate of 20 percent of the total assets of a credit union. This provision therefore facilitates member business lending without jeopardizing safety and soundness at participating credit unions.

Section 202. Definition of Member Business Loans
This section would amend the current definition of a MBL to facilitate such loans by giving the NCUA the authority to exclude loans of $100,000 or less as de minimus, rather than the current limit of $50,000.

Section 203. Restrictions on Member Business Loans
This section would modify language in the Federal Credit Union Act that currently prohibits a credit union from making any new MBLs if its net worth falls below 6 percent. This change will permit the NCUA to determine if such a policy is appropriate and to oversee all MBLs granted by an undercapitalized institution.

Section 204. Member business loan exclusion for loans to non-profit religious organizations
This section excludes loans or loan participations by federal credit unions to non-profit religious organizations from the MBL limit contained in the Federal Credit Union Act, which is 12.25% of the credit union's total assets. This amendment would offer some relief in this area by allowing federal credit unions to make MBLs to religious-based organizations without concern about the statutory limit that now covers such loans. While the limit would be eliminated, such loans would still be subject to other regulatory requirements, such as those relating to safety and soundness.

We believe that this is really a technical amendment designed to correct an oversight during passage of CUMAA. The law currently provides exceptions to the MBL caps for credit unions with a history of primarily making such loans. Congress simply overlooked other credit unions that purchase parts of these loans, or participate in them. This provision would clarify that oversight and ensure that these organizations can continue meeting the needs of their members and the greater community at large and ensuring that loans are available for religious buildings as well as their relief efforts.

Section 205. Credit Unions Authorized to Lease Space in Buildings with Credit Union Offices in Underserved Areas
This section enhances the ability of credit unions to assist distressed communities with their economic revitalization efforts. It would allow a credit union to lease space in a building or on property in an underserved area on which it maintains a physical presence to other parties on a more

permanent basis. It would permit a federal credit union to acquire, construct, or refurbish a building in an underserved community, then lease out excess space in that building.

Having described briefly how CURIA would address credit union member business lending concerns, I would like to provide the Subcommittee with a detailed rationale for these needed changes.

HELPING SMALL BUSINESS

Title II, Section 203 of CUMAA established limits on credit union MBL activity. There were no statutory limits on credit union member business lending prior to 1998. The CUMAA-imposed limits are expressed as a 1.75 multiple of net worth, but only net worth up to the amount required to be classified as well capitalized (i.e., 7%) can be counted. Hence the limit is (1.75 x .07) or 12.25% of assets.

NEED FOR REFORM OF CREDIT UNION MBL LIMITS

Small businesses are the engine of economic growth – accounting for about one-half of private non-farm economic activity in the U.S. annually. Their ability to access capital is paramount. But this access is seriously constrained by the double-whammy of banking industry consolidation and the CUMAA-imposed limitations on credit union MBLs. Recent research published by the Small Business Administration reveals that small businesses receive less credit on average in regions with a large share of deposits held by the largest banks. FDIC statistics show that the largest 100 banking institutions now control nearly two-thirds of banking industry assets nationally. In 1992 the largest 100 banking institutions held just 45% of banking industry assets. Thus, CUMAA severely restricts small business access to credit outside the banking industry at a time when small firms are finding increasing difficulty in accessing credit within the banking industry.

Basic problems with the current MBL limits are:

- **THE LIMITS ARE ARBITRARY AND UNNECESSARILY RESTRICTIVE.** Insured commercial banks have no comparable business lending portfolio concentration limitations. Other financial institutions, savings and loans, for example, have portfolio concentration limitations, but those limitations are substantially less restrictive than the limits placed on credit unions in CUMAA.

- **THE 12.25% LIMIT DISCOURAGES ENTRY INTO THE MBL BUSINESS.** Even though very few credit unions are approaching the 12.25% ceiling, the very existence of that ceiling discourages credit unions from entering the field of member business lending. Credit unions must meet strict regulatory requirements before implementing an MBL program, including the addition of experienced staff. Many are concerned that the costs of meeting these requirements cannot be recovered with a limit of only 12.25% of assets. For example, in today's market, a typical experienced mid-level commercial loan officer would receive total compensation of approximately $100,000. The substantial costs associated with hiring an experienced lender, combined with funding costs and overhead and startup costs (e.g., data processing systems, furniture and equipment, printing, postage, telephone, occupancy, credit reports and other operating expenses) make member business lending unviable at most credit unions given the current 12.25% limitation. In fact, assuming credit unions could carry salary expense of 2% of portfolio, 76% of CUs couldn't afford to be active member business lenders even if they had portfolios that were equal in size to the

current 12.25% of asset maximum. Alternatively, assuming credit unions could carry salary expense of 4% of portfolio, 63% of CUs couldn't afford to be active member business lenders even if they had portfolios that were equal in size to the current 12.25% of asset maximum.

· **THE LIMITS ARE NOT BASED ON SAFETY AND SOUNDENSS CONSIDERATIONS.** There is no safety and soundness reason that net worth above 7% cannot also support business lending. If all net worth could be counted, the actual limit would average between 18% and 19% of total assets rather than 12.25% of total assets.

· **THE MBL DEFINITIONS CREATE DISINCENTIVES THAT HURT SMALL BUSINESSES.** The current $50,000 cutoff for defining an MBL is too low and creates a disincentive for credit unions to make loans to smaller businesses. Permitting the cutoff to rise to $100,000 would open up a significant source of credit to small businesses. These "small" business purpose loans are so small as to be unattractive to many larger lenders. Simply inflation adjusting the $50,000 cutoff, which was initially established in 1993 and hasn't been adjusted since that time, would result in an approximate 33% increase in the cutoff to over $65,000.

While some bankers call credit union member business lending "mission creep" this is simply a preposterous fiction. Credit union member business lending is not new -- since their inception credit unions have offered business-related loans to their members. Moreover, credit union member business lending shows a record of safety. According to a U.S. Treasury Department study, credit union business lending is more regulated than commercial lending at other financial institutions. In addition, the Treasury found that "member business loans are generally less risky than commercial loans made by banks and thrifts because they generally require the personal guarantee of the borrower and the loans generally must be fully collateralized. Ongoing delinquencies – for credit unions, loans more than 60 days past due, and for banks and thrifts, loans more than 90 days past due – are lower for credit unions than for banks and thrifts. Credit unions' mid-year 2000 loan charge-off rate of 0.03 percent was much lower than that for either commercial banks (0.60 percent) or savings institutions (0.58 percent)."

Not surprisingly, the Treasury also concluded that MBL "does not pose material risk to the" National Credit Union Share Insurance Fund.

Updated statistics from full-year 2000 through 2003 indicate that the favorable relative performance of MBLs reported in the Treasury study has continued in recent years. Credit union MBL net chargeoffs have averaged just 0.08% over the four-year period since the Treasury study, while the comparable average net chargeoff rate at commercial banks was 1.28% and at savings institutions it was 1.11%. MBLs have even lower loss rates than other types of credit union lending, which themselves have relatively low loss experience.

Credit union member business lending represents a small fraction of total commercial loan activity in the United States. At mid-year 2004, the dollar amount of MBLs was less than one-half of one percent of the total commercial loans held by U.S. depositories. Credit union MBLs represent just 3.1% of the total of credit union loans outstanding and only 17.9% of U.S. credit unions offer MBLs. According to credit union call report data collected by the NCUA, the median size of credit union MBLs granted in the first six months of 2004 was $140,641.

Currently, only 90 credit unions in Texas offer MBLs, totaling just under 2,200 loans made in 2004. The average MBL in 2004 was $126,000.

Adjusting credit union MBL limits from 12.25% to 20% of assets, which is the equivalent to the business lending limit for savings institutions, would not cause these numbers to change dramatically.

This adjustment would help small business. As noted earlier, small businesses are the backbone of the US economy. The vast majority of employment growth occurs at small businesses. And small businesses account for roughly half of private non-farm gross domestic product in the U.S. each year.

An example of a MBL at a credit union in Texas involves a woman who joined San Antonio Teachers Credit Union, as a teacher, in the early 1970s. Several years after she joined, the credit union member decided she would like to open her own floral business. She only needed a $2,000 loan to start her business; however, she either was turned down by "every bank in town" or was asked to use her home as collateral. San Antonio Teachers Credit Union agreed to provide her with a signature loan for $2,000 (without collateral), as long as she maintained some form of income. Using the start-up money to provide floral arrangements for weddings etc., her business flourished, and in two years she opened her own shop in Austin, Texas. The credit she had established with San Antonio Teachers Credit Union enabled her to qualify for a lease on the property. The credit union member has now been in business for 25 years, because of the MBL provided to her through San Antonio Teachers Credit Union. She is now a member of another credit union, the Florist Credit Union in Austin, and has served as Chairman of their Board.

Small businesses are in need of loans of <u>all</u> sizes, including those of less than $100,000, which many have said banks are less willing to make.

Moreover, large banks tend to devote a smaller portion of their assets to loans to small businesses. The continuing consolidation of the banking industry is leaving fewer smaller banks in many markets. In fact, the largest 100 banking institutions accounted for 42% of banking industry assets in 1992. By year-end 2003, the largest 100 banking institutions accounted for 65% of banking industry assets – a 23-percentage point increase in market share in just eleven years.

This trend and its implications for small business credit availability are detailed in a recently released Small Business Administration paper. The findings reveal "credit access has been significantly reduced by banking consolidation...we believe this suggests that small businesses, especially those to which relationship lending is important, have a lower likelihood of using banks as a source of credit."

In reforming credit union MBL limits, Congress will help to ensure a greater number of available sources of credit to small business. This will make it easier for small businesses to secure credit at lower prices, in turn making it easier for them to survive and thrive.

TITLE III: REGULATORY MODERNIZATION

Section 301. Leases of land on federal facilities for credit unions
This provision would permit military and civilian authorities responsible for buildings on federal property the discretion to extend to credit unions that finance the construction of credit union facilities on federal land real estate leases at minimal charge. Credit unions provide important financial benefits to military and civilian personnel, including those who live or work on federal property. This amendment would authorize an affected credit union, with the approval of the appropriate authorities, to structure lease arrangements to enable the credit union to channel more funds into lending programs and favorable savings rates for its members.

Section 302. Investments in securities by federal credit unions
The Federal Credit Union Act limitations on the investment authority of federal credit unions are anachronistic and curtail the ability of a credit union to respond to the needs of its members. The amendment provides additional investment authority to purchase for the credit union's own account certain investment securities. The total amount of the investment securities of any one obligor or maker could not exceed 10 percent of the credit union's unimpaired capital and surplus. The NCUA Board would have the authority to define appropriate investments under this provision, thus ensuring that new investment vehicles would meet high standards of safety and soundness and be consistent with credit union activities.

Section 303. Increase in general 12-year limitation of term of federal credit union loans
Currently, federal credit unions are authorized to make loans to members, to other credit unions, and to credit union service organizations. The Federal Credit Union Act imposes various restrictions on these authorities, including a 12-year maturity limit that is subject to limited exceptions. This section would allow loan maturities up to 15 years, or longer terms as permitted by the NCUA Board.

All Federal credit unions must comply with this limitation. We are very concerned that credit union members seeking to purchase certain consumer items, such as a mobile home, may seek financing elsewhere in which they could repay the loan over a longer period of time than 12 years. While we would prefer for NCUA to have authority to determine the maturity on loans, consistent with safety and soundness, a 15-year maturity is preferable to the current limit. Such an increase in the loan limit would help lower monthly payments for credit union borrowers and benefit credit unions as well as their members.

Section 304. Increase in one-percent investment limit in credit union service organizations
The Federal Credit Union Act authorizes federal credit unions to invest in organizations providing services to credit unions and credit union members. An individual federal credit union, however, may invest in aggregate no more than 1% of its shares and undivided earnings in these organizations, commonly known as credit union service organizations or CUSOs. The amendment raises the limit to 3% percent.

CUSOs provide a range of services to credit unions and allow them to offer products to their members that they might not otherwise be able to do, such as check clearing, financial planning and retirement planning. Utilizing services provided through a CUSO reduces risk to a credit union and allows it to take advantage of economies of scale and other efficiencies that help contain costs to the

credit union's members. Further, as federal credit union participation in CUSOs is fully regulated by NCUA, the agency has access to the books and records of the CUSO in addition to its extensive supervisory role over credit unions.

The current limit on CUSO investments by federal credit unions is out-dated and limits the ability of credit unions to participate with these organizations to meet the range of members' needs for financial services. It requires credit unions to arbitrarily forego certain activities that would benefit members or use outside vendors in which the credit union has no institutional stake. While we feel the 1% limit should be eliminated or set by NCUA through the regulatory process, we appreciate that the increase to 3% will provide credit unions more options to investment in CUSOs to enhance their ability to serve their members.

CUNA also would support raising the borrowing limitation that currently restricts loans from credit unions to CUSOs to 1 percent. We believe the limit should be on par with the investment limit, which under this bill would be raised to 3 percent.

Section 305. Check-cashing and money-transfer services offered within the field of membership

Federal credit unions are currently authorized to provide check-cashing services to members and have limited authority to provide wire transfer services to individuals in the field of membership under certain conditions. The amendment would allow federal credit unions to provide check-cashing services to anyone eligible to become a member.

This amendment is fully consistent with President Bush's and Congressional initiatives to reach out to other underserved communities in this country, such as some Hispanic neighborhoods. Many of these individuals live from pay check to pay check and do not have established accounts, for a variety of reasons, including the fact that they do not have extra money to keep on deposit. We know of members who join one day, deposit their necessary share balance and come in the very next day and withdraw because they need the money. This is not mismanagement on their part. They just do not have another source of funds. And sometimes, a $5.00 withdrawal means the difference between eating or not.

If we are able to cash checks and sell negotiable checks such as travelers checks, we could accomplish two things: save our staff time and effort opening new accounts for short term cash purposes which are soon closed and gain the loyalty and respect of the potential member so that when they are financially capable of establishing an account, they will look to the credit union, which will also provide financial education and other support services. Take the example of one of our credit unions in Pueblo, which attracts migrant workers who live in that area for several months each year, many who return year after year. It is well known that this particular group is taken advantage of because of the language barrier. The Pueblo credit union has developed a group of bi-lingual members who are willing to act as translators when needed and several successful membership relationships have resulted.

Legislation that includes similar provisions is pending in both the House and Senate on this issue: the International Consumer Protection Act, introduced in the House (H.R. 928) by Representative Gutierrez and in the Senate (S. 31) by Senator Sarbanes. Additionally, the Expanded Access to Financial Services Act (H.R. 749), introduced by Representatives Gerlach and Sherman, contains identical language to this provision, and passed the House of Representatives on April 26, 2005, by

voice vote. CUNA strongly supports all legislative efforts to pursue this provision and is grateful for the extensive interest by Committee members, and particularly wish to thank Representatives Gerlach, Sherman, and the entire House for passing H.R. 749.

Section 306. Voluntary mergers involving multiple common bond credit unions
In voluntary mergers of multiple bond credit unions, NCUA has determined that the Federal Credit Union Act requires it to consider whether any employee group of over 3,000 in the merging credit union could sustain a separate credit union. This provision is unreasonable and arbitrarily limits the ability of two healthy multiple common bond federal credit unions from honing their financial resources to serve their members better.

The amendment is a big step forward in facilitating voluntary mergers, as other financial institutions are permitted to do. It provides that the numerical limitation does not apply in voluntary mergers.

Section 307. Conversions involving common bond credit unions
This section allows a multiple common bond credit union converting to or merging with a community charter credit union to retain all groups in its membership field prior to the conversion or merger. Currently, when a multiple group credit union converts to or merges with a community charter, a limited number of groups previously served may be outside of the boundaries set for the community credit union. Thus, new members within those groups would be ineligible for service from that credit union. The amendment would allow the new or continuing community credit union to provide service to all members of groups previously served.

Section 308. Credit union governance
This section gives federal credit union boards flexibility to expel a member who is disruptive to the operations of the credit union, including harassing personnel and creating safety concerns, without the need for a two-thirds vote of the membership present at a special meeting as required by current law. Federal credit unions are authorized to limit the length of service of their boards of directors to ensure broader representation from the membership. Finally, this section allows federal credit unions to reimburse board of director volunteers for wages they would otherwise forfeit by participating in credit union affairs.

There has been more than one occasion when some credit unions would have liked to have had the ability to expel a member for just cause. It is relatively rare that things occur that would cause credit unions to use such a provision. However, the safety of credit union personnel may be at stake. One instance I know of involved a credit union member who seemed to have a fixation on an employee and had made inappropriate comments. Another involved an older member who refused to take no for an answer from a young teller whom he persistently asked to date. We have heard of an example at another credit union when one member actually told one of the tellers he would punch her if he ever saw her out in public. Most cases are not quite that extreme; however, we have had other reports from credit unions of unruly members who seem to enjoy causing a ruckus.

Credit unions should have the right to limit the length of service of their boards of directors as a means to ensure broader representation from the membership. Credit unions, rather than the federal government, should determine term limits for board members. Providing credit unions with this right does not raise supervisory concerns and should not, therefore, be denied by the federal government.

Credit unions are directed and operated by committed volunteers. Given the pressures of today's economy on many workers and the legal liability attendant to governing positions at credit unions, it is increasingly difficult to attract and maintain such individuals. Rather than needlessly discourage volunteer participation through artificial constraints, the Federal Credit Union Act should encourage such involvement by allowing volunteers to recoup wages they would otherwise forfeit by participating in credit union affairs.

Whether or not a volunteer attends a training session or conference is sometimes determined by whether or not that volunteer will have to miss work and not be paid.

Section 309. Providing NCUA with greater flexibility in responding to market conditions
Under this section, in determining whether to lift the usury ceiling for federal credit unions, NCUA will consider rising interest rates or whether prevailing interest rate levels threaten the safety and soundness of individual credit unions.

Section 310. Credit Union Conversion Voting Requirements
This section would change the Federal Credit Union Act from permitting conversions after only after a majority of those members voting approve a conversion, to requiring a majority vote of at least 20 percent of the membership to approve a conversion.

Time and time again, Congress has made clear its support for credit unions, in order to assure consumers have viable choices in the financial marketplace. Yet, banking trade groups and other credit union detractors have indicated they would like to encourage credit union conversions, particularly those involving larger credit unions, in order that they may control the market, thereby limiting consumers' financial options.

Last year, the NCUA adopted new regulatory provisions to require credit unions seeking to change their ownership structure to provide additional disclosures to their members to insure they are adequately informed regarding the potential change and are fully aware of the consequences of such action. CUNA strongly supported this action because we feel members should know that their rights and ownership interests would change, particularly if the institution converts to a bank. In such a situation the institution would "morph" from one in which the members own and control its operations to an institution owned by a limited number of stockholders.

CUNA likewise supports the agency's ongoing efforts to ensure members are provided sufficient disclosures and opportunities to present opposing views in relation to a possible conversion.

Congress addressed conversions in CUMAA and reinforced that a credit union board which desires to convert must allow its members to vote on its conversion plan. CURIA would require a minimum level of participation in the vote -- at least 20% of the members -- for a conversion election to be valid. Currently, there is a requirement that only a majority of those voting approve the conversion. The legislation would prevent situations in which only a very small number of an institution's membership could successfully authorize such a conversion.

Last year, CUNA's Governmental Affairs Committee developed a resolution that was adopted by our Board relating to credit union ownership, and we want to share its provisions with the Committee.

- The credit union charter presents the best vehicle for serving the financial needs of consumers;
- Credit unions considering changing ownership structure to a bank or thrift charter should decide solely on the basis of what is best for the members of the credit union--not for the management or directors;
- The credit union system should identify and recommend ways to keep the credit union's net worth in the hands of its members;
- Credit unions should provide plain language, full disclosure of all relevant information--including the pros and cons--of a change in the ownership and governance of the credit unions;
- Ensure that credit union senior management and directors are not unjustly enriched, and that appropriate penalties will be imposed for noncompliance with disclosure and other requirements designed to protect the interests of the members; and
- CUNA is rededicated to the improvement of the credit union charter.
- CUNA will continue to look for ways, working with Congress and regulators, to insure a credit union's membership is fully aware of the consequences of a conversion prior to any membership vote.

Section 311. Exemption from pre-merger notification requirement of the Clayton Act
This section gives all federally insured credit unions the same exemption as banks and thrift institutions already have from pre-merger notification requirements and fees of the Federal Trade Commission.

Section 312. Treatment of credit unions as depository institutions under securities laws
This section gives federally insured credit unions exceptions, similar to those provided to banks, from broker-dealer and investment adviser registration requirements.

H.R. 3505—Financial Services Regulatory Relief Act of 2005(Credit Union Provisions)
While H.R. 3505 is a comprehensive bill that benefits banks, thrifts, and credit unions, as well as their customers and members, for the most part my comments will be limited to the credit union provisions. Most of the provisions of CURIA, as outlined above, are also included in H.R. 3505. Important exceptions are the following sections.

Section 301. Privately insured credit unions authorized to become members of a Federal Home Loan Bank
CUNA supports this section which permits privately insured credit unions to apply to become members of a Federal Home Loan Bank. Currently, only federally insured credit unions may become members. The state regulator of a privately insured credit union applying for Federal Home Loan Bank membership would have to certify that the credit union meets the eligibility requirements for federal deposit insurance before it would qualify for membership in the Federal Home Loan Bank system.

Section 314. Clarification of definition of net worth under certain circumstances for purposes of prompt corrective action

Although this provision is also included in CURIA, I want to emphasize that CUNA strongly supports this new provision that was originally introduced as H.R. 1042 by Chairman Bachus and subsequently passed by the House of Representatives. We are grateful for the acknowledgement of the importance of this issue by the Chairman and the swift action by the House, as well as its inclusion in H.R. 3505.

Additionally, there are some generic provisions in H.R. 3505 that will help all financial institutions, including the new agreement on currency transaction reports.

Additional Legislative Amendments CUNA Supports

None of the following provisions have been included in H.R. 3505 or CURIA, yet represent legitimate burdens faced by credit unions that are deserving of relief. We encourage the Subcommittee to consider including them in any future legislation.

- **Allow community credit unions to continue adding members from groups that were part of the field of membership (FOM) before the credit union converted to a community charter but are now outside the community**

Prior to the adoption of amendments to the Federal Credit Union Act in 1998, community credit unions were able to add new members from groups that they had previously served but are outside of the community area the credit union serves. Currently, the credit union may serve members of record but not include additional members from those groups. CUNA supports legislation that would restore that capacity to credit unions.

- **Allow credit unions to serve underserved areas with an ATM**

The legislative history to the CUMAA indicates that federal credit unions should establish a brick and mortar branch or other facility rather than establishing an ATM to serve an underserved area. This directive makes it far less affordable for a number of credit unions to reach out even more to underserved areas. While credit unions serving underserved areas through an ATM should be as committed to the area as a credit union with another type of facility, this change would facilitate increased service to underserved areas.

- **Eliminate the requirement that only one NCUA Board member can have credit union experience**

Currently, only one member of the NCUA Board may have credit union experience. Such a limit does not apply to any of the other federal regulatory agencies and denies the NCUA Board and credit unions the experience that can greatly enhance their regulation. At a minimum, the law should be changed to permit **at least one** person with credit union experience on the NCUA Board.

- **Accounting Treatment of Loan Participations as Sales**

Many of our members currently engage in loan participations, either as the originating institution or as an investor, and FASB's project to review FASB Statement (FAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, is of great concern to us. Other financial institution groups, as well as federal financial regulators, have likewise raised serious questions about the need for and advisability of the proposed guidance.

For a variety of reasons, participations can be important financial and asset liability management tools. They are used increasingly by credit unions, as well as by other institutions, to control interest rate risk, credit risk, balance sheet growth, and maintain net worth ratios. Participations enable credit unions to utilize assets to make more credit available to their membership than they would be able to do without the use of loan participations.

FASB states that it is concerned that in a loan participation in which the borrower has shares or deposits at the originating institution, if that institution is liquidated, the participating institution would not be able to recover its pro rata portion of the members' shares/deposits within the originating institution that are "claimed" by the originating institution to setoff the portion of the debt owed to it. This outcome is highly unlikely and we are not aware that it has ever occurred in a credit union.

Nonetheless, FASB is considering amendments to Statement of Financial Accounting Standard 140 that would expressly state that because the right of setoff between the originating institution and the member/depositor/borrower exists (setting up the potential that the participating institution would not have any claim against the member/depositors' funds in the originating institution) the loan transaction does not meet the isolation requirements of FAS 140. Because of this concern, instead of transferring the portion of the loan participated off of its books as a sale, it is our understanding that the transaction would be reflected on the originating credit union's financial statements and records as a secured borrowing.

In order for participations to continue being treated as sales for accounting purposes, the amendments would further change the existing accounting standards by requiring an institution to transfer participations through a qualified special purpose entity (QSPE), if the transaction did not meet 'True-Sale-At-Law" test. This is a needless and costly expense that would make it difficult for credit unions to use participation loans as a management tool. Further, it would drastically limit the ability of credit unions to provide low-cost, economical financing for their membership through loan participations.

There are sufficient safeguards already in place that address FASB's concerns about isolating the loan participation asset from the reach of the originating credit union and its creditors in liquidation, without the need for changes to FAS 140 of the nature FASB is contemplating.

Conclusion

In summary, Mr. Chairman, we are grateful to the Subcommittee for holding this important hearing. We strongly support H.R. 3505, and we urge the Subcommittee to act on this very important issue this year. And, we strongly urge the Subcommittee to make sure that CURIA is a part of any

Congressional action to provide financial institutions regulatory relief. CURIA is our future. Without CURIA, millions of Americans will be deprived of a credit union able to respond to their needs.

Testimony of Norma Alexander Hart
President, National Bankers Association
Before the Subcommittee on Financial Institutes and
Consumer Credit of the Financial Services Committee of
The United States House of Representatives

Good morning Chairman Bachus, Ranking Member Sanders and other distinguish members of the Subcommittee on Financial Institutions and Consumer Credit. My name is Norma Alexander Hart, I am President of National Bankers Association (NBA). It is my pleasure to provide comments on behalf of the association regarding H.R. 3505 "The Financial Service Regulatory Relief Act of 2005" pending before Congress.

For nearly eighty years, the NBA has served as the primary trade organization advocating for minority and women owned financial institutions. Moreover, the NBA, and its fifty member banks and thirty associate members, has worked with the federal government to develop policies, regulations and laws that recognize the importance of preserving and fostering minority owned and controlled banking institutions.

1. Regulatory Relief Has Been Around for Years. First, let me commend the committee for its hard work on this issue. We have been supporting this effort for a number of years on the Hill. The NBA is pleased to support the overall thrust of the Regulatory Relief Bill. There are many regulations that need to be updated or in some cases eliminated to make the banking industry more competitive and available to the American public.
   Too many lower income Americans are still "unbanked" and we hope that this bill will make it easier for financial institutions to offer services to this important segment of our population.

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2. Purpose of the Act to Update Regs and to Lift Regulatory Burden on Banks. The regulations imposed by the regulators often disproportionably burden the minority and women owned banks.

   Efforts should be made to streamline compliance of regulations that are intrusive and costly to banks with deposits of $300 million or less:

   For example:

   1) Sarbanes-Oxley internal controls

   2) IT compliance

   3) Bank Secrecy Act

   4) Privacy Issues and

   5) Patriot Act Reporting

   Each of the above regulations impose a high cost to compliance. These costs impose a severe burden on small minority owned institutions.

3. DeNovo Banks. Specifically, we note our concern about the provisions of the act that open the financial services industry to enterprises and industries that would use banking and mortgage lending as an ancillary service to their primary business. The NBA does not believe financial services should be provided as a commodity at over the counter stores or fast food restaurants. Consumers should not go mortgage shopping at the same time they are food shopping. This will undermine the safety and soundness of the banking industry in America.

   The NBA is concerned about non traditional ownership of financial institutions. Regulators must take a fresh and close look at this issue. The Act should impose separation between the retail and banking services. Restrictions on locations and cross

marketing efforts should be imposed. If retail chains are invited into the banking industry they should be available to offer only limited services and their roll-out should be staggered. This committee should not open the doors to widely.

4. Preservation of Minority Banks by Section 308 of FIRREA. Pursuant to Section 301 and 308 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) Congress has mandated that the FDIC and OTS conduct activities that recognize and preserve the special and unique status of minority owned financial institutions.

   Over the years, this legislation has lost much of its relevance and impact. As a result the number of minority and women owned banks is decreasing. This regulation should expand to include other regulatory bodies and the regulators should be instructed to (OCC, Treasury and Federal Reserve Board) undertake deliberate efforts to foster the number and competitiveness of minority institutions. Additionally, regulators should provide minority banks the first opportunity to acquire "troubled institutions" or other banks or savings institutions that are being divested.

Conclusion. The NBA suggest that this historic legislation be modified to ensure the continued vitality of minority and women owned banking in America. We look forward to working with the Subcommittee and its staff to accomplish that goal.

We thank you for this opportunity to testify and I am available for questions and comments from this distinguished panel.

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Testimony
by
David E. Hayes
President/CEO of Security Bank
Dyersburg, TN
&
Chairman
Independent Community Bankers of America
Washington, DC

H.R. 3505
"Financial Services Regulatory Relief Act 2005"

United States House of Representatives
Financial Services Committee, Subcommittee on
Financial Institutions and Consumer Credit

October 18, 2005

Mr. Chairman, Ranking member Sanders and members of the subcommittee, my name is David Hayes, Chairman of the Independent Community Bankers of America ("ICBA")[1] and President and CEO of Security Bank; a $135 million community bank in Dyersburg, Tennessee. I am pleased to appear today on behalf of ICBA and its nearly 5,000 members to testify on H.R. 3505, the Financial Services Regulatory Relief Act of 2005, introduced by Reps. Jeb Hensarling and Dennis Moore. We endorse their initiative.

Earlier this year, ICBA testified before this subcommittee about community banks' need for relief from the severe regulatory burden that we face[2]. I will not repeat those comments today, except to say that reducing the regulatory burden remains a top concern of community bankers and that we strongly support this subcommittee's efforts to reduce it.

In summary, ICBA:

- Greatly appreciates the inclusion of several provisions from the Communities First Act (H.R. 2061) as part of H.R. 3505 and recommends adding additional CFA provisions.
- Strongly supports the Gillmor/Frank compromise on industrial loan companies as a first step toward closing the ILC loophole.
- Supports the subcommittee's effort to reduce the burden and enhance the effectiveness of Bank Secrecy Act compliance.
- Strongly opposes increasing credit union powers so long as they have an unfair tax and regulatory advantage over community banks.
- Urges the Congress to quickly enact hurricane relief legislation.

[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. For more information, visit ICBA's website at www.icba.org.

[2] Testimony of Terry Jorde, President/CEO, CountryBank USA, Cando, ND, and Chairman-Elect Independent Community Bankers of America, May 19, 2005

Communities First Act

ICBA greatly appreciates the fact that the bill before us (H.R. 3505) includes five provisions from Rep. Jim Ryun's Communities First Act (H.R. 2061). CFA includes a number of regulatory and tax relief items that would be very helpful to community banks and our consumer, small business, and local government customers who depend on us for financial support. By lifting the yoke of regulatory burden from our backs, and moving us closer to tax parity with tax-exempt credit unions, the CFA would allow community banks to focus our resources on serving our customers and communities.

CFA has gained tremendous bi-partisan support in the House, with 75 sponsors, and was introduced in the Senate as S. 1568 with three sponsors. A total of 43 state banking trade associations have also endorsed CFA. (List of endorsing associations attached.)

The following provisions from CFA are included in the Hensarling/Moore bill:

- ***Streamlining Call Reports*** *(Hensarling/Moore 606; CFA 204).* Calls on the agencies to reduce or eliminate the information required for reports of condition if the information is "no longer necessary or appropriate."

- ***Flexible Exam Schedule for Community Banks*** *(Hensarling/Moore 607; CFA 107).* Expands the eligibility for the 18-month exam cycle from banks under $250 million in assets to banks up to $1 billion.

- ***Short Form for Call Reports*** *(Hensarling/Moore 608; CFA 102).* Permits highly rated, well-capitalized banks with assets of $1 billion or less to file a short form Call Report every other quarter.

- ***Changes to Small BHC Policy Statement*** *(Hensarling/Moore 616; CFA 104).* Requires the Federal Reserve to revise the Small Bank Holding Company Policy Statement on Assessment of Financial and Managerial Factors so that the policy applies to BHCs with assets of less than $1 billion that are not engaged in any nonbanking activities involving significant leverage and do not have a significant amount of outstanding debt. (The current policy applies to BHCs with assets under $150 million. Subsequent to introduction of CFA, the Federal Reserve proposed to increase the level to $500 million.)

- ***Exception to Annual Privacy Notice*** *(Hensarling/Moore 617; CFA 203).* Exempts a bank from the annual privacy notice requirement if the bank does not share customer information other than as permitted by one of the exceptions in the Gramm-Leach-Bliley Act, does not share information with affiliates under the Fair Credit Reporting Act, and has not changed its policies.

These provisions will be very helpful to community banks and we are grateful that the committee has included them in its bill. In addition, we strongly urge the committee members to take another look at the Communities First Act to determine if there are additional provisions that can be added to H.R. 3505.

In particular, we urge you to include the following sections of the Communities First Act:

- ***Consideration of Community Bank Impact***. Section 109 of the Communities First Act requires that before establishing or making any revision in any regulation, requirement, or guideline, the appropriate banking agency must to take into account the effect on community banks and savings associations. The OCC has already adopted a formal policy along these lines and it is appropriate that the other agencies follow suit.

- ***Truth-in-Lending Act Three-Day Right of Rescission***. Section 201 of the Communities First Act 1) directs the Federal Reserve to prescribe regulations authorizing customers who borrow from Federally insured depository institutions to waive the three-day right of rescission, 2) exempts a refinancing with a new lender from the three-day right of rescission where no new money is advanced, and 3) exempts home equity lines of credit from the three-day right of rescission.

  The three-day right of rescission, while it may protect consumers from unscrupulous lenders, has imposed a major inconvenience for borrowers from legitimate lenders such as insured banks. It makes little sense to impose this waiting period on borrowers who are doing business with legitimate lenders, who are not borrowing new funds, or who are establishing home equity lines. When there is no new money lent, the delay simply makes the borrower wait for the lower interest rate or other benefit from the new loan. In the case of a line of credit, the borrower already has a built in right of rescission; they can wait three days (or three months, or longer) before drawing on the line.

- ***Loans to Officers and Directors***. Section 108 of the Communities First Act allows banks with less than $1 billion in total assets to make loans to directors and officers, in the aggregate, up to two times capital. The current asset size limit is $100 million in deposits. This adjusts this limit to the growth in average bank assets, but it is not a tenfold increase. That is because a bank with $1 billion in assets could have considerably less than that in deposit liabilities.

  Section 205 would help all banks by increasing to $250,000 the special regulatory lending limit on loans to executive officers for loans other than those for housing, education, and certain secured loans.[3] This limit was set at $100,000 in 1978. If adjusted for inflation, the limit would be $296,000 today. So this amendment simply makes an appropriate adjustment for inflation.

- ***Management Interlocks.*** We note that section 404 of the Hensarling/Moore bill would increase the size of banks eligible for an exemption from interlocking director prohibitions from $20 million to $100 million. Section 105 of the Communities First Act would increase the level to $500 million. It has always been a challenge for the smallest institutions to find qualified directors. Now that directors' responsibilities have increased under the Sarbanes-Oxley Act and other requirements, this has become a challenge even for larger community banks. We hope the subcommittee will consider increasing the level in section 404 to $500 million to address this problem.

Industrial Loan Companies

As the subcommittee members know, Wal-Mart recently applied for an industrial loan company charter in Utah and for Federal deposit insurance. ICBA and the other members of the Sound Banking Coalition strongly oppose the Wal-Mart application. We believe that this proposal to mix banking and commerce poses a special threat to the FDIC, the nation's payments system, and the communities we serve. ICBA's letter to the FDIC and the coalition's letter are included as an Appendix to my testimony.

The fact that the nation's largest and most aggressive retailer has applied for, essentially, a state banking charter, highlights the urgency of this issue. That is why ICBA strongly supports the Gillmor/Frank compromise that would limit the branching powers of new ILCs that are not owned by primarily financial companies. This would prohibit predominantly commercial firms from buying or establishing an industrial loan company and using the new branching authority to establish nationwide banking operations.

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[3] Executive officers would remain subject to the same limit on directors and principal shareholders, the loans-to-one-borrower limit, and to the requirement that loans to insiders not be on preferential terms

Parent companies of ILCs are not subject to the Bank Holding Company Act. Federal Reserve Governor Mark Olson testified before Congress that, "Allowing a commercial firm to operate a nationwide bank outside the supervisory framework established by Congress for the owners of insured banks raises significant safety and soundness concerns and creates an un-level competitive playing field." We agree.

A Government Accountability Office (GAO) report on ILCs released September 22, 2005 found that ILC parent companies are not adequately regulated and pose increased risks to the deposit insurance fund. GAO called on Congress to close the regulatory gap between ILCs and commercial banks, and urged Congress to consider the risks inherent in allowing ILCs to be owned by commercial firms.

GAO found that even though FDIC examines and supervises insured ILCs, "it has less extensive authority to supervise ILC holding companies than the consolidated supervisors of bank and thrift holding companies [i.e., the Federal Reserve and the OTS]." The report continued, "these ILCs may pose more risk of loss to the bank insurance fund than other insured depository institutions operating in a holding company," adding that, "Congress should consider strengthening the regulatory oversight accorded to ILCs."

The financial risks faced by Wal-Mart are not similar to those faced by most banks and create unique problems due to its enormous size, scope, and complexity of its operations. This makes the need for holding company supervision even more urgent. The Bank Holding Company Act gives the Federal Reserve the authority to examine the bank holding company itself and any of its non-bank subsidiaries at any time, while the FDIC has only limited examination authority, and it is generally unable to examine affiliates of banks.

The Federal Reserve also has the authority to establish consolidated capital requirements to ensure that owners are a source of financial strength for the subsidiary bank. Corporate parents of ILCs are not subject to these capital requirements.

In addition, the Federal Reserve has broad enforcement authority and can issue cease and desist orders, impose civil penalties, and order a holding company to divest non-bank subsidiaries if it determines that ownership of the subsidiary poses a risk to the affiliated bank. The Federal Reserve is the only federal agency authorized to take such actions against bank holding companies.

GAO also raised concerns about mixing banking and commerce when ILCs are owned by commercial companies. The GAO said it finds "it unusual that a limited ILC exemption would be the primary means for mixing banking and commerce on a broader scale and sees merit in Congress taking a broader look at allowing ILCs or other entities to engage in this level of activity."

The Wal-Mart application presents a prime example of the dangers of concentration of resources and impaired credit availability that flow from allowing a commercial company such as Wal-Mart to own a bank or ILC. And in Wal-Mart's particular case, these dangers are amplified because of the company's enormous size, market clout and role in destroying the vitality of many small town centers.

Will a competing local hardware or clothing store, a local pharmacy, or someone wishing to establish a new store, be able to obtain credit from the Wal-Mart bank, or want to share its confidential business plans with the Wal-Mart bank? The Wal-Mart bank would have no incentive -- in fact it would have a disincentive -- to lend to businesses that compete with its parent company.

Consumers and households likewise will be ill-served by a Wal-Mart bank. If the past is prologue, local banks, just like local retailers in towns where Wal-Mart has located, will face unfair competition. While the initial effect may be cheaper services at the Wal-Mart bank, the long-term effect will be reduced choices for consumers as the number of financial services providers shrinks

A Wal-Mart owned bank will not be able to look at other factors beyond a consumer's credit score to understand the customer's individual circumstances and cannot make the customer a loan based on a long-standing relationship and personal knowledge of the customer—something community banks do every day.

ICBA believes that the best way to deal with and eliminate the mixing of banking and commerce made possible by the ILC loophole is to close it by bringing ILCs under the Bank Holding Company Act. However, the Gillmor/Frank language is a reasonable first step that should be included in any proposal to relax branch restrictions or add other new powers for ILCs.

Bank Secrecy Act Compliance

ICBA appreciates Congress's oversight of the implementation of the Bank Secrecy Act and the efforts against terrorist financing and money laundering. We believe your efforts have helped swing the pendulum away from the "zero tolerance" policies that some examiners had adopted and that were driving legitimate businesses away from the nation's banks.

Clearly, this is an area that requires sustained attention, since bankers across the country continue to identify BSA compliance as one of the most costly and burdensome issues they face. ICBA looks forward to continuing to work with Congress, Treasury, and the banking agencies to develop a reporting system that focuses on truly suspicious transactions, simplifies the system to eliminate reporting of routine transactions with no value for law enforcement, and properly balances costs and benefits.

Continuing their cooperation announced last year on matters of BSA compliance, Treasury and the bank regulatory agencies jointly issued an examination manual on June 30 and the agencies have conducted outreach meetings with industry on the new procedures. This is a very welcome approach to the problem. Section 702 of H.R. 3505 will further codify this cooperation in the area of monetary transaction recordkeeping and reporting, so we strongly endorse it.

Community bankers recognize the need to balance the needs of law enforcement with the need for effective BSA compliance. Section 701 represents another attempt to improve the exemption process for filing currency transaction reports (CTRs) to eliminate unnecessary costly reports of routine legal transactions. However, it is important to recognize that it is far easier for most community banks to file CTRs, rather than implement an exemption process. Similarly, for many larger banks, the process of filing the reports is fully automated, and many have decided that not using the exemption process is less burdensome, less confusing and less risky (especially because it eliminates risk of criticism by examiners).

In the current environment, bankers, especially community bankers, may continue to be reluctant to use the "seasoned customer" exemption. It is important to note that, despite Congressional mandates to reduce the number of unnecessary CTRs since 1994, efforts have been unsuccessful. While the ICBA believes the provisions of H. R. 3505 are a step in the right direction, the risks involved with implementing such exemptions might discourage community banks from using this option.

Therefore, ICBA favors a simple increase in the CTR filing threshold. An increase would adjust the threshold to take account of inflation (the filing threshold has been $10,000 since it was set by statute in 1970) and reduce the number of filings for routine, legal transactions. Perhaps more important, it would be simple to apply.

Nonetheless, the specific measures in H.R. 3505 send a very valuable signal to Treasury, law enforcement, and the regulatory agencies that Congress is concerned about these issues and wishes to achieve a better balance. Thank you for your continuing efforts in this area.

Credit Union Provisions

In our testimony earlier this year, we emphasized that – unlike the Communities First Act – the credit union industry bill (H.R. 2317) goes far beyond regulatory relief. The credit union bill is a powers enhancement proposal, while the Communities First Act includes no new powers for anyone. ICBA strongly opposes new powers for credit unions so long as they have an unfair tax and regulatory advantage over community banks.

CFA is strictly designed to lift the regulatory and tax burden for community banks and help level the playing field. In contrast, the credit union bill would, among other things substantially increase the ability of tax-exempt credit unions to make loans to businesses. Therefore, we are pleased that this provision and the one that would allow credit unions to reduce their capital are not included in H.R. 3505.

There is one area where we believe credit unions very much need regulatory relief. Earlier this year, the National Credit Union Administration, attempted to undermine two Texas credit unions' ability to choose to convert to a mutual thrift charter. NCUA invalidated a vote by one credit union's members to convert solely because of the way the required disclosure was folded. Fortunately, after a Federal magistrate's decision against it, NCUA settled the case and permitted the credit union to convert. However, this was just the latest example of NCUA's efforts to unreasonably block credit union conversions. To prevent further abuse, ICBA strongly urges the subcommittee to vote for Rep. McHenry's bill (H.R. 3206) that would eliminate NCUA's ability to micromanage the conversion process.

Hurricane Relief Recommendations

The recent Gulf Coast hurricanes, Katrina and Rita, have highlighted a need for regulatory relief targeted to financial institutions in those areas. ICBA testified last month in detail about our recommendations for relief by Congress and the agencies[4]. Several bills introduced in the House include items that were part of our recommendations. We recommend that Congress enact all of these bills as expeditiously as possible.

Hurricane Check Cashing Relief Act of 2005 *(H.R. 3909)* introduced by Rep. Ginny Brown-Waite. The bill would provide up to $2,000 in reimbursement to a financial institution that has cashed a check for someone from an area affected by Hurricanes Katrina and Rita if the check is un-collectable. This will help those

[4] Testimony of C. R. (Rusty) Cloutier, President/CEO, MidSouth Bank in Lafayette, LA and Past Chairman of the Independent Community Bankers of America, September 14, 2005

customers who had to flee from the hurricanes without their identification and other personal papers or who later lost them during evacuation. Financial institutions will be more likely to cash checks for people in need because the bill offers compensation in cases where, even when making their best efforts, a check they cash is returned without payment.

The bill appropriately rewards those banks that, in the early days after the disaster, did the right thing and provided cash when ATMs were not working. At that time, cash was essential, but individuals' normal source of cash was unavailable.

Hurricanes Katrina and Rita Flood Insurance Buy-In Act of 2005 *(H.R. 3922)* introduced by Rep. Gene Taylor. This bill would extend flood insurance coverage to properties that had not been in designated flood risk areas. It would require the property owner to pay 105 percent of premiums for the preceding 10 years and also require that the property be covered in the future. This will greatly assist communities damaged by these extraordinary storms to begin to rebuild while protecting additional properties from future losses.

Hurricane Katrina Financial Services Relief Act of 2005 *(H.R. 3945)* introduced by Rep. Richard Baker. Key provisions of this bill would:

- Require the Federal Reserve to waive wire-transfer fees for affected banks;
- Authorize the federal banking agencies to exercise flexibility in enforcing capital requirements; and
- Exclude deposits of casualty insurance proceeds when calculating a bank's capital requirements.

The enhanced flexibility for banks' capital requirements is particularly important for the reconstruction of local communities. Without this flexibility, community banks most affected by hurricane losses would be less able to provide badly needed loans to businesses and consumers seeking to rebuild. As the bill recognizes, it makes great sense to allow well-managed banks to remain in operation even though their capital is temporarily reduced due to the effects of the hurricane on customers and deposits.

ICBA recommends that H.R. 3945 be broadened to include banks in areas affected by Hurricane Rita.

Conclusion

ICBA very much appreciates this opportunity to again testify on the importance of regulatory relief. We are pleased that significant sections of Rep. Ryun's Communities First Act have been included in the Hensarling/Moore bill, and hope that other provisions can be added as the bill moves forward. We are also pleased that H.R. 3505 includes the Gillmor/Frank compromise on industrial loan companies. This is vital so long as these state-chartered banks can be purchased or established by commercial firms. Finally, we again urge the Congress to act quickly on legislation to provide relief to communities and community banks affected by the hurricanes along the Gulf Coast.

State Associations Endorsing the Communities First Act (8.12.05):

- The Community Bankers Association of Alabama
- Arkansas Community Bankers
- California Independent Bankers
- Independent Bankers of Colorado
- Florida Bankers Association
- Community Bankers Association of Georgia
- Community Bankers Association of Illinois
- Community Bankers Association of Indiana
- Iowa Bankers Association
- Iowa Independent Bankers
- Community Bankers Association of Kansas
- Kansas Bankers Association
- Heartland Community Bankers Association
- Bluegrass Bankers Association (BBA) in Kentucky
- Community Bankers of Louisiana
- Maine Association of Community Banks
- Michigan Association of Community Bankers
- Minnesota Bankers Association
- Independent Community Bankers of Minnesota
- Missouri Bankers Association
- Missouri Independent Bankers Association
- Montana Bankers Association
- Montana Independent Bankers
- Nebraska Independent Community Bankers
- Community Bankers Association of New Hampshire
- Independent Community Bankers Association of New Mexico
- Independent Bankers Association of New York
- North Carolina Bankers Association
- Independent Community Banks of North Dakota
- North Dakota Bankers Association
- Community Bankers Association of Ohio
- Community Bankers Association of Oklahoma
- Oklahoma Bankers Association
- Oregon Bankers Association
- Pennsylvania Association of Community Bankers
- Independent Banks of South Carolina
- Independent Community Bankers of South Dakota
- Independent Bankers Division/ Tennessee Bankers Association
- Tennessee Bankers Association
- Independent Bankers Association of Texas
- Texas Bankers Association
- Virginia Association of Community Banks
- Washington Independent Community Bankers Association
- West Virginia Association of Community Bankers
- Community Bankers of Wisconsin
- Bankers Bank Council

August 18, 2005

Honorable Donald E. Powell
Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Mr. John F. Carter
Regional Director
Federal Deposit Insurance Corporation
25 Jessie Street at Ecker Square, Suite 2300
San Francisco, California 94105

Re: Comments Regarding FDIC Application #20051977; Wal-Mart Application for Insurance and Industrial Bank Charter

Dear Chairman Powell and Mr. Carter:

On behalf of its 5,000 members, the Independent Community Bankers of America[5] writes to comment on the Wal-Mart Stores, Inc. application for a Utah industrial bank or industrial loan company charter (ILC) and federal deposit insurance. ICBA opposes the application and urges the FDIC to deny the application. ICBA further requests the FDIC to conduct a public hearing on the application and the serious public policy issues it raises.

ICBA is a founding member of the Sound Banking Coalition, which is also filing a letter opposing the application and requesting a hearing. ICBA

[5] *The Independent Community Bankers of America, the nation's voice for community banks, represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry.*

incorporates by reference herein the arguments and issues raised in the Sound Banking Coalition's letter. The Coalition also filed a letter dated August 10, 2005 objecting to Wal-Mart's omission of essential elements about the company's plans for the ILC from the public portion of its application. Lack of this essential information makes it impossible for the public to adequately assess the application or fully comment on it. Accordingly, the Coalition requested the FDIC to require that Wal-Mart disclose more information and to extend the comment period for an additional thirty days.

Although Wal-Mart professes a narrow business plan for the ILC, the application nonetheless presents very serious public policy issues regarding the appropriate structure of our financial and economic system. The application by the world's largest company—with $290 billion in revenue, 3,600 U.S. retail stores, 1.25 million U.S. employees, and more than 100 million customers a week—presents issues involving the mixing of banking and commerce, impartial allocation of credit, economic concentration, banking supervision, extension of the federal safety net and losses to taxpayers and community disinvestment. For the reasons presented below, the ICBA urges the FDIC to deny the application.

The Wal-Mart Application, Past Failed Attempts to Enter the Banking Business

Wal-Mart's current business plan for the ILC is narrowly described as providing back office processing of credit card, debit card and electronic check transactions in Wal-Mart store.

While the application itself is narrowly drawn, Wal-Mart has had a well-publicized mission to get into the banking business despite the existing legal and regulatory barriers established on long-held public policy grounds to prevent the full blown mixing of banking and commerce in our nation. Wal-Mart's repeated past attempts to gain a foothold in banking and combine full-service banking with its retail operations on a nationwide basis give rise to skepticism about its current narrow business plan.

In 1998, Wal-Mart attempted to purchase a small unitary thrift institution in Broken Arrow, Oklahoma. The Congress shut down this back-door approach for a commercial firm to enter the banking business when it passed the Gramm-Leach-Bliley Act of 1999 and reaffirmed our nation's policy of separating banking and commerce by closing the "unitary thrift holding company" loophole and prohibiting commercial firms from owning or acquiring savings associations (as they are prohibited from owning banks).

Wal-Mart later sought to enter banking through an arrangement with Toronto-Dominion Bank USA to offer banking services in 100 Wal-Mart stores. This attempt was blocked by the Office of Thrift Supervision, which objected to Wal-Mart's plan to share profits with TD Bank and have its retail store employees perform banking transactions for TD Bank in their stores. OTS found such an arrangement would give Wal-Mart illegal control over TD Bank USA, circumventing the Gramm-Leach-Bliley Act prohibition on a commercial firm becoming a savings and loan holding company.

Lastly, Wal-Mart sought to purchase a small California industrial bank in 2002. In the face of Wal-Mart's application, the California legislature blocked the acquisition by passing a law prohibiting commercial firms from owning ILCs.

Despite any current non-legally binding pledges from Wal-Mart regarding its business plan for a Utah ILC—such as a "no branching" pledge—we see nothing to prevent Wal-Mart from chartering the ILC on a narrow business plan, and later seeking the approval of the Utah Department of Financial Institutions and the FDIC to expand its business and conduct full service banking in its stores. We also see nothing to prevent any conditions placed on the approval of a narrow charter by the Utah DFI being removed in the future upon application by the Wal-Mart ILC.

Conflict of Interest Inherent in Mixing of Banking and Commerce

The linchpin of the financial and economic system of the United States is the principle of the separation of banking and commerce. This tradition has resulted in the most vibrant, successful and diversified economic and financial system in the world. The walls separating banking and commerce prevent conflicts of interest and undue concentration of resources, and ensure the impartial allocation of credit so vital to economic growth and development and to a safe and sound financial system.

The Wal-Mart application presents a prime example of the dangers of concentration of resources and impaired credit availability that flow from allowing a commercial company such as Wal-Mart to own a bank or ILC. And in Wal-Mart's particular case, these dangers are amplified because of the company's enormous size, market clout and role in destroying the vitality of many small town centers.

Numerous small towns and communities have experienced the devastating loss of locally-owned and operated retailers, and disinvestment after Wal-Mart establishes a store on the outskirts of town. The Wal-Mart store in essence becomes the new "downtown" once the town center has been depleted of viable competitors. Indeed Wal-Mart Supercenters house under one roof full-line grocery stores along with the 36 general merchandise departments of Wal-Mart (including clothing, health and beauty aids, household, electronics, toys, lawn and garden, jewelry, pharmacy, snack bar or restaurant and shoes), plus specialty shops such as a vision center, tire and lube services, photo processing, dry cleaner, beauty parlor, video rental, etc. Various retail outlets competing with Wal-Mart have charged it engages in predatory pricing practices to capture market share, then raises prices once competitors have been eliminated. See, e.g., "Is Wal-Mart Too Powerful?" *Business Week,* October 6, 2003; "When Wal-Mart Pulls Out, What's Left?", *New York Times*, March 5, 1995; "Store Shuts Doors on Texas Town; Economic Blow for Community," *USA Today,* October 11, 1990; "Arrival of Discounter Tears Civic Fabric of Small-Town Life," *Wall Street Journal,* April 14, 1987.

Because of this common history and experience of many communities, when evaluating the application the ICBA urges the FDIC to consider what will happen to credit availability and customer and community service when the Wal-Mart bank siphons deposits from locally-owned and operated community banks, impairing their ability to continue to support economic growth and development in their communities through lending, and driving them out of business.

Will a competing local hardware or clothing store, a local pharmacy, or someone wishing to establish a new store, be able to obtain credit from the Wal-Mart bank, or want to share its confidential business plans with the Wal-Mart bank? The Wal-Mart bank would have no incentive -- in fact it would have a disincentive -- to lend to businesses that compete with its parent company. Instead of making impartial credit decisions based on the creditworthiness of the borrower, the Wal-Mart bank would have incentive to deny credit, not on the merits, but because of a conflict of interest and its relationship with Wal-Mart.

Ownership by Wal-Mart would have a similar effect on the bank's decision-making with regard to credit applications by Wal-Mart suppliers. Again, instead of making credit decisions on the merits of a borrower's creditworthiness, the Wal-Mart bank would have an incentive to favor Wal-Mart's suppliers and disfavor their competitors. In fact, Wal-Mart could require its suppliers to obtain their banking and credit services from the Wal-Mart bank if they want to do business with Wal-Mart.

Impact on Consumers, Community Disinvestment

Consumers and households likewise will be ill-served by a Wal-Mart bank. If the past is prologue, local banks, just like local retailers in towns where Wal-Mart has located, will no longer be able to compete. While the initial effect may be cheaper services at the Wal-Mart bank, the long-term effect will be reduced choices for consumers as the number of financial services providers shrinks, and as the products become more commoditized.

A Wal-Mart owned bank will not be able to look at other factors beyond a consumer's credit score to understand the customer's individual circumstances and cannot make the customer a loan based on a long-standing relationship and personal knowledge of the customer—something community banks do every day.

Moreover, there is the danger that Wal-Mart will export deposits out of the local community. This has been the current pattern of the large retailer when it establishes itself in a local community. The retailer's deposits do not stay with local banks, but rather are transferred to the store's central headquarters. This pattern in the past has had a devastating effect on local communities as retail dollars spent in the community are exported elsewhere and do not remain in the community to support local lending and economic development.

Safety and Soundness Concerns, Holding Company Supervision

The Wal-Mart application also illustrates that the affiliation of banks and nonbanking companies presents conflicts of interest and safety and soundness concerns. Federal Reserve Chairman Alan Greenspan has repeatedly argued that the mixing of banking and commerce presents safety and soundness concerns and poses the specter that the federal safety net protecting depositors of insured institutions will spread to non-depository affiliates, thereby introducing additional risks to the deposit insurance funds and the taxpayers.

Because of the ILC loophole in the Bank Holding Company Act, parent companies of ILCs, unlike other companies that own banks, are not regulated at the holding company level by the Federal Reserve. "Allowing a commercial firm to operate a nationwide bank outside the supervisory framework established by Congress for the owners of insured banks raises significant safety and soundness concerns and creates an unlevel competitive playing field," the Federal Reserve has testified. "Congress has established consolidated supervision as a fundamental component of bank supervision in the United States because consolidated supervision provides important protection to the insured banks that are part of a larger organization and to the federal safety net that supports those banks. Financial trouble in one part of an organization can spread rapidly to other parts. To protect an insured bank that is part of a larger organization, a supervisor needs to have the authority and tools to understand

the risks that exist within the parent organization and its affiliates and, if necessary, address any significant capital, managerial, or other deficiencies before they pose a danger to the bank."

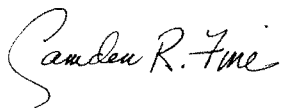
Wal-Mart's enormous size make these considerations and the risk posed to the Bank Insurance Fund and taxpayers in the event Wal-Mart experiences financial difficulties more acute.

While the FDIC would have the authority and tools to address safety and soundness problems confined to the Wal-Mart ILC, it lacks the essential tools the Bank Holding Company Act gives the Federal Reserve to oversee and supervise bank holding companies and ensure the safe operation of the overall enterprise. For example, the Federal Reserve's supervisory authority over bank holding companies includes: general examination authority, consolidated umbrella supervision, capital requirements and enforcement authority for unsafe and unsound activities at the parent company or affiliate. This lack of safeguards at the holding company level puts the Wal-Mart bank, the Bank Insurance Fund, and taxpayers at jeopardy for trouble at its parent company.

Conclusion

For the reasons stated herein and in the Sound Banking Coalition's August 17, 2005 letter, the ICBA urges the FDIC to reject Wal-Mart's application for federal deposit insurance for a Wal-Mart ILC. The application presents serious public policy issues inherent in the mixing of banking and commerce and in the ILC loophole and warrants a public hearing to allow adequate public comment. The issues presented—conflicts of interest, economic concentration, lack of impartial credit decisions, inadequate holding company supervision, and inappropriate extension of the federal safety net—are amplified by Wal-Mart's size and market clout. The threat of community disinvestment is particularly acute in this case because of Wal-Mart's track record and destructive impact in hundreds of communities across the United States. Our nation's long-standing principle of separation of banking and commerce, reaffirmed in the Gramm-Leach-Bliley Act, is the underpinning for our stable and highly successful economic and financial system, and should not be allowed to be skirted by the world's largest commercial company.

Sincerely,



Camden R. Fine
President and CEO

August 17, 2005

Mr. John F. Carter
Regional Director
Federal Deposit Insurance Corporation
25 Jessie Street at Ecker Square
San Francisco, California 94105

Re: Initial Comments and Request for Public Hearings Regarding FDIC Application # 20051977 – Wal-Mart Application for Insurance and Industrial Bank Charter

Dear Mr. Carter:

The undersigned members of the Sound Banking Coalition – the Independent Community Bankers of America, the National Association of Convenience Stores, the National Grocers Association, and the United Food and Commercial Workers International Union – submit this letter in opposition to Wal-Mart's application for a Utah industrial bank[6] charter and FDIC insurance, and to request a public hearing on the matter. As noted in our August 10 letter, Wal-Mart failed to provide crucial information regarding its proposed bank in the publicly available application. Public release of this information is needed to allow for full, meaningful comment. Therefore, this letter serves as preliminary comments and the Coalition reserves the right to submit additional comments following the public release of necessary information. In addition, the fundamental issues raised by this application by the largest commercial company in the United States to acquire a bank charter are so numerous and complex that the FDIC must hold public hearings in order to get a full airing of these issues.

Although Wal-Mart has narrowly drafted its Application to make it appear that it would use an industrial bank charter primarily to process internal transactions, Wal-Mart does not foreclose the possibility that it would eventually seek to branch and enter retail banking. To the contrary, we believe that a careful examination of Wal-Mart's application and past efforts to obtain a bank reveal that this application is a first step toward an expansion into retail banking.

Wal-Mart's application raises difficult policy issues. The mixing of banking and commerce that would occur if Wal-Mart owned a bank as well as the lack of consolidated supervision of the bank by the Federal Reserve Board threaten some of the basic underpinnings of banking regulation in the United States. These threats are particularly acute here given that Wal-Mart is the largest commercial company in the United States.

[6] Industrial banks are alternatively referred to as Industrial Loan Companies or ILCs in these comments.

The Federal Reserve and Chairman Alan Greenspan have repeatedly raised questions about the lack of regulation of industrial banks and the need for holding company level regulation of these banks by the Federal Reserve. The risks of industrial banks were summed up well by Federal Reserve Governor Mark Olson when he testified: "Allowing a commercial firm to operate a nationwide bank outside the supervisory framework established by Congress for the owners of insured banks raises significant safety and soundness concerns and creates an unlevel competitive playing field." Like the Federal Reserve, a number of public interest groups including the Consumer Federation of America, National Consumer Law Center, ACORN, Consumers Union, National Association of Consumer Advocates, National Community Reinvestment Coalition, and the U.S. Public Interest Research Group have raised concerns about the public policy implications of the industrial bank loophole in the Bank Holding Company Act.[7]

As a general matter, we believe that Wal-Mart's application should be denied because the very possibility that Wal-Mart will enter into retail banking poses an enormous, unjustifiable threat to taxpayers, consumers, small communities, small businesses, FDIC insurance, and the soundness of our banking system itself. As an industrial bank, Wal-Mart could establish banks in its retail stores, causing competitive problems for local bankers in much the same way that it has for local retailers. This would leave Wal-Mart as the only banking option in many small communities and force small businesses to hand their deposits over to, and apply for loans from, their biggest competitor. Further, as an industrial bank, Wal-Mart would not be subject to the consolidated supervision and many of the restrictions applicable to other owners of insured banks. This could make it impossible to detect financial troubles before they have an opportunity to affect the federal insurance safety net.

In addition to these policy considerations, Wal-Mart's application should be denied because Wal-Mart fails to meet the criteria that the FDIC must consider in reviewing insurance applications under Section 6 of the Federal Deposit Insurance Act. Wal-Mart fails to meet these criteria for the following reasons: (1) a Wal-Mart industrial bank would present a grave risk to the Bank Insurance Fund, (2) the application makes it possible for Wal-Mart to enter into retail banking in the future, which would have a destructive impact local communities, (3) legal and ethics issues pose a threat to Wal-Mart's financial condition and future earnings; and (4) there are serious questions about Wal-Mart meeting FDIC standards for management character and fitness.

[7] See Testimony of Travis Plunkett, Legislative Director, Consumer Federation of America and Carolyn Carter, Of Counsel, National Consumer Law Center, before the Senate Committee on Banking, Housing and Urban Affairs, hearing titled "Current Proposals Considered for Regulatory Relief Legislation," June 21, 2005.

(1) A Wal-Mart Bank Would Pose an Enormous Threat to the Bank Insurance Fund and the Banking System Itself

The sheer size of Wal-Mart presents a grave risk to the Bank Insurance Fund. Because of Wal-Mart's size and volume of business, the losses that the FDIC would endure if the bank or the parent company experienced financial problems could be very large. Commenting on the impact Wal-Mart's size and influence already has on dependent suppliers, Tom Rubel, CEO of consultant Retail Forward Inc. predicted that "If [Wal-Mart] ever stumbles, we've got a potential national security problem on our hands. They touch almost everything....If they ever really went into a tailspin, the dislocation would be significant and traumatic."[8] A company this large should not be permitted to place our banking system and the Bank Insurance Fund at a similar risk.

Wal-Mart faces particular risks that other banks, not to mention many other commercial enterprises do not. Prominent examples of these risks include financial risks due to foreign currency fluctuations and fluctuations in oil prices. For example, Wal-Mart is exposed to substantial risk when there are fluctuations in the yuan. More than seventy percent of goods sold by Wal-Mart are made in China.[9] Xu Jun, Wal-Mart China's director of external affairs, has pointed out that China is Wal-Mart's most important supplier in the world and noted, "If Wal-Mart were an individual economy, it would rank as China's eighth-biggest trading partner, ahead of Russia, Australia and Canada."[10] More than 5,000 Chinese enterprises have established steady supply alliances with Wal-Mart.[11]

The commercial ties between Wal-Mart and China pose particular risks because China is loosening its artificial control of the valuation of its currency. On July 21, 2005, the Chinese government dropped the yuan-dollar peg and lifted the value of the currency by more than two percent. The revaluation raised the price of Chinese goods, pressuring profit margins on an enormous proportion of the products sold in Wal-Mart. While this first step in floating the yuan resulted in a relatively modest increase of the currency, economists have estimated that China's currency policy has kept the yuan undervalued by as much as forty percent.[12] AG Edwards advised its clients regarding the float of the yuan: "We believe that China's decision. . .will have an immediate impact for U.S. retailers sourcing product out of China. U.S. retailers cost of goods sold will increase and, of course, their gross margins will decrease."[13] A sudden jump in the valuation of the yuan could have devastating consequences for Wal-Mart and, if Wal-Mart becomes as dominant in the financial services sector as it has been in other segments of the economy, a decision made in Beijing regarding the valuation of its currency could put a Wal-Mart bank and, by extension, the Bank Insurance Fund at risk.

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[8] Business Week, *Is Wal-Mart Too Powerful?*, Oct. 6. 2003, *available at* http://www.businessweek.com/magazine/content/03_40/b3852001_mz001.htm

[9] Jiang Jingjing, *Wal-Mart's China inventory to hit US$18b this year,* China Business Daily, November 29, 2004, *available at* http://www2.chinadaily.com.cn/english/doc/2004-11/29/content_395728.htm.

[10] *Id.*

[11] *Id.*

[12] Dow Jones, *Retail Stocks Lower in 'minor' China Revaluation*, July 21, 2005.

[13] *Id.*

Wal-Mart also faces risks from rising oil prices. Wal-Mart's stock price has fallen in reaction to recent news about oil prices and the August 16 statement by CEO H. Lee Scott, Jr. that, "I worry about the effect of higher oil prices . . . I anticipate challenges as the year progresses." These risks include increases in the costs Wal-Mart must pay to transport the large volume of goods it sells as well as the risk that as consumers spend additional funds on fuel they will have less to spend at Wal-Mart. As Mr. Scott said in the August 16 call, "Our customer continues to be impacted by higher gas prices, and it is difficult to improve our expense leverage in the current environment." These financial risks faced by Wal-Mart are not similar to those faced by most banks and create unique problems due to the size and scope of Wal-Mart's worldwide supply network and operation.

These risks are particularly significant because Wal-Mart, as an industrial bank, would not be subject to Federal Reserve oversight. This leaves insufficient safeguards to ensure that this massive company will not endanger the Bank Insurance Fund. Although a Wal-Mart bank would be subject to oversight by the FDIC, the FDIC does not have the same powers to regulate the entirety of a holding company's operations as does the Federal Reserve. The Bank Holding Company Act (BHCA) provides the Federal Reserve with the authority to examine the bank holding company itself and any of its non-bank subsidiaries at any time, while the FDIC has only limited examination authority, and is unable to examine affiliates of banks unless necessary to disclose the direct relationship between the bank and affiliate and the effect of the relationship on the bank.[14] The Federal Reserve is also entitled to establish consolidated capital requirements to ensure that bank holding companies are a source of financial strength for the subsidiary bank. Corporate parents of ILC's are not subject to these capital requirements. Finally, the Federal Reserve has broad enforcement authority under the BHCA, and can issue cease and desist orders, impose civil penalties, and order a holding company to divest non-bank subsidiaries if it determines that ownership of the subsidiary presents a risk to the financial safety, soundness, or stability of an affiliated bank and is inconsistent with sound banking principles or the purposes of the BHCA.[15] The Federal Reserve is the only federal agency authorized to take such actions against bank holding companies.

The safeguards provided by Federal Reserve regulation would be necessary to protect the Bank Insurance Fund against the potential risks presented by a Wal-Mart bank. Without these safeguards, it may be impossible for problems to be identified and managed in time to prevent deficiencies and damage to the federal safety net. A Wal-Mart bank is simply a risk that United States tax payers should not be forced to take.

[14] Letter to Senator Tim Johnson from Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, June 25, 2003, at 4.
[15] *Id.* at 5.

(2) A Wal-Mart Bank Would Have a Destructive Impact on Local Communities

Although Wal-Mart claims that it will simply use the industrial bank charter to process credit card, debit card, and electronic check transactions from its retail locations, Wal-Mart has not denied that it will pursue retail banking in the future. When asked whether shoppers could someday shop for mortgages at Wal-Mart, financial services director Tom McLean refused to say that Wal-Mart would not offer these types of retail banking services replying instead, "We continue to look for what makes sense to the customer."[16] Certain statements in the filing also indicate that Wal-Mart's application is really an attempt to get its foot into the door of retail banking. For example, it states that it will offer short-term certificates of deposit to nonprofit and educational organizations, as well as "individual investors generated through deposit brokers." There is no detail about who these investors will be, and no guarantee that the bank will not offer them additional banking services.

Further, the application is only the most recent in a series of unsuccessful attempts by Wal-Mart to enter the financial services industry. In 1999, Wal-Mart tried to purchase a small savings and loan company in Oklahoma, but was stopped by provisions of the Gramm-Leach-Bliley Act.[17] In 2001, it attempted to partner with the Canadian Toronto-Dominion Bank, but its application was rejected as deficient by the Office of Thrift Supervision.[18] The application with Toronto-Dominion was explicit in noting Wal-Mart's plan to offer retail banking services in its retail stores. In fact, one of the deficiencies in the application was that the plan contemplated having retail cashiers function as bank tellers.

Most recently, in 2002, Wal-Mart filed an application to acquire an industrial bank in California. The effort met with resistance from those concerned about the mixing of banking and commerce, and was ultimately blocked by the California legislature.[19] While right now Wal-Mart is publicly stating that it seeks only to save the costs of a third party processor for retail transactions, its current application is merely a continuation of its past efforts to enter into retail banking.

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[16] Becky Yerak and Josh Noel, *Wal-Mart Plan Has Bankers on Edge,* Chicago Tribune, July 20, 2005, *available at* http://www.chicagotribune.com/business/chi-0507200160jul20,1,3606468.story?coll=business-utl

[17] Jenifer K. Nii, *Wal-Mart is Planning to Open a Bank in Utah,* Desertnews.com, July 19, 2005, *at* http://deseretnews.com/dn/view/0,1249,600149522,00.html

[18] Christopher Leonard, *Retailer Seeking Banking Inroads,* Arkansas Democrat Gazette, July 20, 2005.

[19] Mark Anderson, *Wal-Mart Will Look Elsewhere to Buy Bank,* Sacramento Business Journal, Oct. 2, 2002.

Granting Wal-Mart an industrial bank charter would allow it to branch into more than 20 states under current law – and that number could easily grow. Wal-Mart's entrance into banking would have such a destructive impact on local communities and businesses throughout Utah and the United States that the mere possibility that it would use an industrial bank charter for this purpose should be enough reason to deny the application. Wal-Mart's retail business has frequently been criticized for having a destructive impact on local communities and businesses. It has a pattern of entering local communities and using predatory pricing and other techniques to run all local competition out of business. Once local competition is destroyed, Wal-Mart is free to raise its prices, or even shut down its stores to open larger regional stores. There is no reason to believe that a Wal-Mart bank would not engage in the same practices and have the same effects on local banks.

A study conducted by Iowa State University revealed that, following Wal-Mart's expansion in the state, 555 grocery stores, 298 hardware stores, 293 building suppliers, 161 variety shops, 158 women's apparel stores, 293 building suppliers, and 116 pharmacies closed.[20] When Wal-Mart opened three Sam's Club (Sam's) stores in Oklahoma, local gas stations were initially pleased due to the business generated by traffic traveling to and from the stores. Wal-Mart quickly usurped the opportunity by providing gas below wholesale prices at its own stores, and caused local gas stations to lose a large volume of sales. A federal judge in the Western District of Oklahoma enjoined and restrained Sam's from selling motor fuel below cost as defined by the Oklahoma Unfair Sales Act, and the Tenth Circuit affirmed.[21] According to the Tenth Circuit, the evidence showed that "because of the volume of Sam's gasoline sales and its below-cost pricing, competition was lessened in Oklahoma City [in much of the] area surrounding Sam's stores."[22]

Wal-Mart has repeated this pattern – aggressively harming local businesses and competition – many times. The grocery business is a prime example. Studies by Retail Forward, a market research firm, indicate that for every one Wal-Mart "Supercenter" opened, two local groceries will close.[23] The following is an explanation of the devastating effect that this can have on communities:

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[20] Stone, *Competing with Discount Mass Merchandisers*, at http://www.econ.iastate.edu/faculty/stone/1995_IA_WM_study.pdf

[21] *See Star Fuel Marts, LLC, v. Sam's East, Inc.*, 362 F.3d 639, 643 (10th Cir. 2004).

[22] *Id.* at 649.

[23] Business Week, *Is Wal-Mart Too Powerful?*, Oct. 6. 2003, *available at* http://www.businessweek.com/magazine/content/03_40/b3852001_mz001.htm.

> "As the number of supermarkets shrinks, more shoppers will have to travel farther from home and will find their buying increasingly restricted to merchandise that Wal-Mart chooses to sell -- a growing percentage of which may be the retailer's private-label goods. Meanwhile, the failure of hundreds of stores will cost their owners dearly and put thousands out of work, only some of whom will find jobs at Wal-Mart, most likely at lower pay."[24]

Indeed, some estimate that for every one job created by Wal-Mart, two are lost. Wal-Mart has also driven many American jobs overseas. Relentlessly seeking lower prices, the company has shifted much of its purchasing power overseas, where cheap labor and minimal government regulation result in cheaper goods. Gary Gereffi, a Duke University professor who studies global supply chains, has stated that Wal-Mart is one of the "key forces" propelling global outsourcing because it controls so much of the purchasing power of the U.S. economy.[25] In 2004, Wal-Mart reportedly purchased $9 billion-worth of goods directly and another $9 billion indirectly from China.[26] In 2005, Wal-Mart plans to purchase more than $2 billion in goods from India,[27] and to increase purchasing of Malaysian products by 20 percent.[28]

The adverse effect that Wal-Mart has had on local businesses, workers, and communities in the retail industry should not be permitted to repeat itself in the banking industry. An industrial bank charter would give Wal-Mart the opportunity to destroy local banks much as it has destroyed other local businesses such as grocers, pharmacists, and florists. If competitor banks are destroyed, surviving local businesses would be forced to go to their biggest competitor for deposits and loans, providing Wal-Mart with an even greater competitive advantage and creating a nightmare scenario which is a key reason for the longstanding U.S. policy prohibiting the mixture of banking and commerce.
A Wal-Mart bank also will not help the local community in Salt Lake City. Wal-Mart has indicated in its application that it will outsource many of the bank's functions (although it has failed to reveal where or to whom). Wal-Mart's application states that it will outsource its general ledger and accounting system and implies that it will outsource its information systems. Not only will this deprive the local community of jobs, the lack of information about how and where this outsourcing will occur raises troubling questions about the bank's operations and oversight. The application also pointedly says only that Wal-Mart "does not have any plans to relocate the main office within the first three years of its operations."

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[24] *Id.*
[25] Interview by Frontline with Gary Gereffi, Professor, Duke University (Sept. 9 2004), *available at* http://www.pbs.org/wgbh/pages/frontline/shows/walmart/interviews/gereffi.html .
[26] The Economist, *Wal-Mart: How Big Can it Grow?*, April 15, 2004 *available at* http://www.economist.com/business/displayStory.cfm?story_id=2593089
[27] India Business Insight, *Government to Set Up Panel to Help Wal-Mart Source Goods*, June 3, 2004.
[28] Namnews, *Malaysia: Wal-Mart To Increase Malaysia Sourcing By 20%*, Aug. 5, 2005, *at* http://www.kamcity.com/namnews/asp/newsarticle.asp?newsid=23489.

For these reasons, a Wal-Mart bank would have an adverse impact on local communities – including banks, other local businesses, their workers, and their customers. This appears likely to be true in Salt Lake City and Utah as well as the rest of the country. Therefore, if the convenience and needs of the community are to be considered, the Wal-Mart application must be denied.

(3) Wal-Mart's Legal and Ethical Problems Present Serious Risks to its Financial Condition and Future Earning Potential

Wal-Mart is one of the most often sued companies in history. Wal-Mart was reportedly sued 4,851 times in 2000 — or nearly once every two hours, every day of the year.[29] Wal-Mart continues to be besieged by litigation. These lawsuits create enormous potential liabilities that could eventually lead the company, and, if it acquires one, its bank to fail.

For example, an employment discrimination class action is currently pending in which the plaintiffs, over 1.5 million current and former female employees, could be entitled to as much as $10 billion in back pay, punitive damages, and raises. The case may lead to a very expensive judgment or settlement. In addition, Wal-Mart recently has entered into an $11 million settlement agreement over a federal investigation of its labor practices and been fined $3.1 million for violations of the Clean Water Act. These troubles could also scare away investors, require expensive fixes, and lead to a decrease in profits and stock prices.

The cases cited above are just a small, recent sampling of the lawsuits that have been brought against Wal-Mart. The potential liabilities stemming from present and future lawsuits create huge financial risks for the company. In May of 2005, a group of institutional investors holding more than $545 million worth of Wal-Mart stock voiced concern about an apparent breakdown in the company's legal and regulatory controls. The group, which includes William C. Thompson Jr., the comptroller of New York City, stated that they were "deeply concerned about contingent liabilities and negative effects on the company's stock price and reputation," and urged the company to establish a special committee of independent directors to review and report on the company's legal and regulatory controls.[30]

The shareholders warned the company that "recent reports of legal and regulatory non-compliance raise serious concerns about the adequacy of the company's controls," and that "the frequency of the reports suggests that non-compliance with internal standards, as well as with laws and regulation, may be far too commonplace at Wal-Mart."[31] The letter cited raids of 60 Wal-Mart stores in 21 states by U.S. federal agents that resulted in

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[29] Richard Willing, *Lawsuits a Volume Business at Wal-Mart*, USA Today, Aug. 13, 2001, *available at* http://www.nfsi.org/walmart/Lawsuits%20a%20volume%20business%20at%20Wal-Mart.htm (last visited Aug. 2, 2005).

[30] Letter from William C. Thompson, Jr., Comptroller, The City of New York, *et. al.*, to Roland A. Hernandez, Chair, Audit Committee of the Board of Directors, Wal-Mart Stores, Inc. 1 (May 25, 2005) *available at* http://www.comptroller.nyc.gov/press/2005_releases/PR05-06-067.shtm.

[31] *Id.*

the arrest of 250 illegal immigrant workers and the $11 million settlement mentioned above, and a 2005 settlement with the U.S. Department of Labor involving more than 24 violations of child labor laws in three states.

The shareholders also voiced concern about a recent corporate scandal. Former Wal-Mart Vice Chairman Thomas Coughlin reportedly was forced to resign from Wal-Mart's board after an internal investigation alleged that he abused his expense account and used fraudulent invoices to obtain reimbursements. Coughlin allegedly informed co-workers that the funds were actually a "round-about way" of compensating him for out-of-pocket expenses he made to wage an anti-union campaign involving bribes.[32] The shareholder letter also noted that the employee who reported Coughlin's suspect transactions was subsequently fired. If it is discovered that Wal-Mart executives have been misusing company funds to finance illegal anti-union activities, this could lead to further litigation, reduce investor confidence in the company, and have serious financial consequences. Wal-Mart's increasingly negative public image has led to countless organized challenges from citizens and local governments seeking to keep Wal-Mart out of their communities.[33] These efforts could also pose a threat to Wal-Mart's future growth and overall financial health.

Wal-Mart's pattern of legal and regulatory non-compliance is particularly concerning because, as an Industrial bank, it would not be regulated by the Federal Reserve as are other bank holding companies. Therefore, the potential financial impact of Wal-Mart's frequent legal and regulatory violations and resulting liabilities may not be detected in time to prevent financial problems before they endanger the bank and the Bank Insurance Fund. As Wal-Mart shareholders have themselves cautioned, "the risks associated with a compliance breakdown are especially onerous for Wal-Mart and its shareholders in light of the company's large size and market capitalization."[34]

(4) Concerns about Wal-Mart Meeting FDIC Standards for Management Character and Fitness

One of the criteria by which the FDIC must evaluate this application is the general character and fitness of management. We sincerely hope that any unproven claims against Wal-Mart are false, and that past violations will not be repeated, but Wal-Mart's existing track record of legal and ethical violations is too much to ignore. Under these circumstances, we do not believe that Wal-Mart's management should be extended the authority and responsibility that comes with an industrial bank charter and FDIC

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[32] James Bandler & Ann Zimmerman, *Petty Cash: A Wal-Mart Legend's Trail of Deceit*, Wall Street Journal, Apr. 8. 2005, *available at* http://mindfully.org/Industry/2005 /Wal-Mart-Coughlin8apr05.htm.

[33] *See, e.g.*, Julie Edgar, *Township May Shut Door on Wal-Mart*, Detroit Free Press, July 27, 2005; Laura Counts, *'Super' Grocery Outlets Banned in Oakland; Lawmakers Vote to Turn Away Wal-Mart and Target*, Alameda Times-Star, Oct. 23. 2003; *Wal-Mart Hits Big Apple Pothole*, CNNMoney.com, Feb. 24, 2005; Russell Max Simon, *Wal-Mart Battle Comes to Santa Fe*, Albuquerque Journal, April 24, 2004, at Journal North Pg. 1; Donal O'Connor, *City Urged to Say No to Wal-Mart; Crowd Cheers as Speakers Blast U.S. Retail Giant*, Stratford Beacon Herald, June 21, 2005, at News Pg. 1.

[34] Letter from William C. Thompson, Jr. at 2.

insurance, particularly in light of the fact that Wal-Mart will not be subject to consolidated supervision by the Federal Reserve.

The reports of violations of labor and environmental laws, alleged discrimination in employment and sales practices, and negative impacts on communities raise questions about the character of Wal-Mart's management. The picture these allegations paint is just what Wal-Mart's shareholders found – that breaking laws and regulations is "far too commonplace" at Wal-Mart.

Many of Wal-Mart's shareholders have expressed concern regarding the ethical lapses of the company's management. With respect to the scandal over Coughlin's alleged misuse of company funds, a shareholder group stated that the incident merely "bolstered the public perception of a culture of non-compliance and disregard for ethical standards within the ranks of Wal-Mart management."[35] In light of Wal-Mart's practices and legal problems, the FDIC cannot assure itself that Wal-Mart's management will instill a culture of compliance and ethical practices at its bank that will protect its customers and the public.

* * *

Wal-Mart's application for an industrial bank is troubling on many fronts and should be rejected. It does not meet the basic legal requirements upon which the FDIC judges such applications and it would open so broadly the ILC loophole in the BHCA that the long-time separation of banking and commerce would no longer be a recognizable principle. Concerned taxpayers, consumers, small businesses and bankers should be entitled to present facts concerning the destructive impact that a Wal-Mart industrial bank would have on the convenience and needs of their communities, and further facts must be presented to elaborate on the financial history and condition of the institution, its future earning prospects, the adequacy of its capital structure, the character and fitness of its management, and the risk that the depository institution will present to the deposit insurance fund. Written submissions during the comment period are insufficient to make an adequate presentation of these issues and facts to the FDIC, making a public hearing necessary. The need for a public hearing is particularly pressing due to Wal-Mart's failure, as noted in our August 10 letter, to disclose crucial information about its proposed bank in the public application.

Respectfully,

Sincerely,

Vice President, Congressional Relations
Affairs Director
Independent Community
Bankers of America

Senior Vice President
Government Relations
National Association of Convenience Store

Senior Vice President
and General Counsel
National Grocers Association

Legislative and Political
United Food and Commercial
Workers International Union

cc: Alan Whitchurch, Incorporator

[35] *Id.*

Testimony of

Bradley E. Rock

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit

Of the

Committee on Financial Services

United States House of Representatives

October 18, 2005

Testimony of Bradley E. Rock

on behalf of the

American **Bankers** Association

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October 18, 2005

Mr. Chairman and members of the Subcommittee, my name is Bradley Rock. I am Chairman, President, and CEO of Bank of Smithtown, an $800 million community bank located in Smithtown, New York, founded in 1910. I am also the Vice Chairman of the American Bankers Association (ABA). ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

I am glad to be here today to present the views of the ABA on the need to eliminate unnecessary, redundant, or inefficient regulatory burdens that increase costs for banks and reduce the amount of credit available to our communities. By now, it should not come as news that banks are struggling under the weight of increasing levels of regulatory burdens, many of which do not serve the objective of making the nation's banks operate more soundly or to provide meaningful protections to consumers. The rising level of regulatory burden creates additional red tape and barriers to effective compliance with a wide range of legislative mandates and policy goals. This raises costs to banks and, consequently, places an unnecessary strain upon banks' abilities to efficiently serve their customers.

The USA PATRIOT Act, the Sarbanes-Oxley Act, and the Gramm-Leach-Bliley Act (GLBA) are all valuable pieces of legislation that strive to serve the public interest. However, overly complex or redundant compliance requirements render these laws far less effective than they would be otherwise. Banks, particularly community banks, are strained to the breaking point under the weight of thousands of pages of regulation, guidance, and other mandates. When the cumbersome layering of additional requirements, issued by the Securities and Exchange Commission (SEC), the Financial Accounting Standards Board (FASB), the Public Company Accounting Oversight Board (PCAOB), and the American Institute of Certified Public Accountants (AICPA) are also taken into account, it is abundantly clear that bank resources are being stretched too thin.

I have had the privilege of testifying before this committee about the urgent need for regulatory relief for banks earlier this year. In addition, ABA has submitted comments to regulators on a wide range of regulatory relief priorities, which would make a real difference in the vitality of our nation's banks. At a September 22 hearing before this committee, chief regulators from the Federal Reserve, Treasury Department, Office of Thrift Supervision, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (FDIC) all expressed strong support for several provisions that ABA supports to reduce regulatory burden on banks. In addition, progress made as a result of the ongoing review of regulatory costs by the federal bank regulators, required by the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA), is very positive.

We are pleased the regulators have acted on some of our recommendations and that our message is apparently being heard. For example, I am particularly pleased with regulators' support for changes that involve the Bank Secrecy Act (BSA), including discontinuing CTR requirements for seasoned customers -- changes that would not only provide relief to banks and our regular customers, but also increase the security of our banking system by identifying criminal activity with greater precision. However, at the end of the day, only Congress's decision to act on these recommendations can make a real difference.

In my testimony, I would like to make three key points:

I. Excessive regulatory burden has a significant impact on bank customers and local economies.

II. Regulatory burden is significant for banks of all sizes, but small banks are particularly affected.

III. There are several important regulatory issues that Congress should address this year, but three are especially pressing to maintain the competitive vitality of my industry. These are the elimination of unnecessary cash transaction reports (CTRs), preventing credit union capital erosion and widening credit union authority in higher-risk lending, and restricting authority under the industrial loan corporation (ILC) charter to prevent the mixing of banking and commerce.

I. Excessive Bank Regulation Harms Consumers, Communities' Economies

Outdated laws and regulations squander scarce resources of banks that could otherwise be used to provide financial services demanded by our customers. New laws, however well intentioned, have added yet more layers of responsibilities on businesses like mine. While no single regulation by itself is overwhelming to most businesses, the cumulative weight of all the requirements is overwhelming.

The burden of regulation has a significant impact on bank customers and local economies. Every new law, regulation or rule added means two things: more expensive bank credit and less of it. This is likely to hurt small businesses the most, as they cannot go directly to the capital markets, yet need low-cost financing. The result is slower economic growth.

During the past 25 years, the compliance burden has grown so large and is so pervasive throughout all levels of bank management that it is extremely difficult to measure. Research done by the ABA and the Federal Reserve[1] indicates that the total cost of compliance ***today*** for banks would range from $34 billion to $42 billion per year and this does not include compliance costs due to legislation enacted in the last five years, such as the USA PATRIOT Act and Sarbanes-Oxley. Compliance costs are expected to grow at an even faster pace in the coming years.

Certainly, some of the regulatory cost is appropriate for safety and soundness reasons. But consider the direct impact on bank lending and economic growth if this burden could be reduced by 20 percent and redirected to bank capital; it would support additional bank lending of $69 billion to $84 billion. This would clearly have a big impact on our economies. In fact, it represents nearly 10 percent of all consumer loans or 11 percent of all small business loans.

[1] "Survey of Regulatory Burden," ABA, June 1992; Elliehausen, "The Cost of Banking Regulation: A Review of the Evidence," Staff Study, Board of Governors of the Federal Reserve System, April 1998.

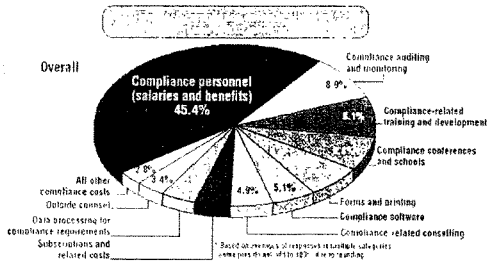
II. Community Banks Hit Especially Hard

Regulatory costs are significant for banks of all sizes, but pound for pound, small banks carry the heaviest regulatory load. For the typical small bank, about one out of every four dollars of operating expense goes to pay the costs of government regulation. For large banks as a group, total compliance costs run into the billions of dollars annually.

The cumulative effect of new rules and regulations will ultimately force many community banks to look for merger partners to help spread the costs; some will go out of business altogether or consolidate with larger banks. Our members routinely mention regulatory burden as the first or second critical factor threatening the viability of his or her community bank. I can tell you, Mr. Chairman, the pressures to comply with all the regulations and still meet the demands of our customers are enormous. We feel that we must grow the bank rapidly to generate more revenues simply to pay for the ever-increasing regulatory cost. The sad part is that too much time and effort is now devoted to compliance and not to serving our customers.

Bankers at all levels, from bank directors and CEOs to compliance managers and tellers, spend endless hours on compliance paperwork. Because of the complexities involved, my bank pays more than $100,000 each year to outside firms to help us with the big compliance issues. On top of this, one person on my staff has a full-time job just to coordinate all the activities throughout the bank related to regulatory compliance. I personally spend about one-and-a-half days per week just on compliance issues. Some CEOs tell me that they are now spending nearly half of their time on regulatory issues. In addition,

banks spend billions annually on compliance training, outside compliance support (including accounting firms, consultants and attorneys), compliance related hardware and software, printing, postage, and telephone connections.



Source: *Compliance Watch, 2003. Nationwide Bank Compliance Officer Survey.* ABA Banking Journal, June 2003.

Banks that can least afford increasing compliance costs are hit the hardest. There are more than ***2,516 banks and thrifts with fewer than 20 employees; nearly 900 banks and thrifts have fewer than 10 employees***. In order to fulfill their compliance obligations, banks of this size often are forced to hire an additional full-time employee just to complete government-mandated reports. According to the Small Business Administration's Office of Advocacy, the total cost of regulation is 45 percent higher per employee for firms with fewer than 20 employees compared to firms with more than 500 employees due to the fixed costs

associated with regulations.[2] The cost versus benefit analysis fails to make the case for many of the rules and regulations banks must follow, and the reports that we generate.

The bottom line is that too much time and too many resources are consumed by compliance paperwork, leaving too little time and resources for providing actual banking services. I'm sure I speak for all bankers when I say that I would much rather be spending my time talking with our customers about their financial needs and how my bank might fulfill them than poring over piles of government regulations. The losers in this scenario are bank customers and the communities that banks serve.

III. CTRs, Credit Unions, & ILCs: The Pressing Three

In the appendix to this testimony is a list of recommended actions, every one of which would provide meaningful and much needed regulatory relief to banks. All of these items are important to my bank. Nevertheless, there are three issues in particular that are especially timely and that I would like to emphasize.

(a) Eliminate CTR Filings for Seasoned Customers

ABA and its members strongly believe that the current cash transaction reporting (CTR) standards have long outlived their utility in detecting possible acts of money laundering and other criminal activity. ABA members believe that CTR filing has been rendered virtually obsolete by several developments: formalized customer identification

[2] Crain, "Impact of Regulatory Costs for Small Firms," Small Business Administration, 2005

programs, more robust suspicious activity reporting and government use of the 314(a) inquiry/response process. We believe that maintaining the CTR threshold at the current level generates too many reports that capture extensive immaterial activity wasting banker and law enforcement time that could be spent on Suspicious Activity Report (SAR) detection and investigation. Consequently, we believe that the time has come to recognize the redundancy of CTR filings for seasoned customers with transaction accounts and to eliminate this inefficient use of resources by bankers and law enforcement.

This sentiment is echoed by the Financial Crimes Enforcement Network (FinCEN) and all the bank regulators. For example, at his September 22 testimony before this committee, FinCEN Director William Fox said ending CTR reporting for seasoned customers is a way to make the CTR reporting system "more effective while still ensuring that currency transaction reporting critical information to identifying criminal activity is made available to law enforcement."

Also, at the same hearing, Federal Reserve Governor Mark Olson testified, "We support the efforts of the Treasury Department and others to develop ways of reducing the burdens imposed on banks in ways that would not adversely affect the ability of banks to manage their risk or unintentionally impede the investigative tools available to law enforcement." Office of the Comptroller of the Currency Chief Counsel Julie Williams, Office of Thrift Supervision Chief Counsel John Bowman, and Texas Banking Commissioner Randall James also expressed support for making changes to the CTR requirements.

Given the widespread support and important benefits of eliminating CTR requirements for seasoned customers, it is not only in the interest of banks that Congress should act, but for law enforcement also.

(b) Reject Efforts to Expand Credit Union Business Lending Authority

ABA strongly opposes the Credit Union Regulatory Improvements Act of 2005 (H.R. 2317). It is our understanding there may be efforts to incorporate provisions of this bill with the regulatory relief legislation now pending before this committee. H.R. 2317 would, among other things, greatly expand credit union commercial lending authority while at the same time undercut the regulation of capital levels at federally-insured credit unions. Taken together, these changes would fuel even more rapid expansion of the government's tax subsidy of an ever-increasing segment of the credit union industry. This segment is comprised of complex credit unions, which today are already virtually indistinguishable from tax-paying banks. Large-scale business lending is inconsistent with Congress's original charge that credit unions serve "people of small means" and should not be encouraged further.

It is important for Congress to recognize that a fundamental change has occurred within the credit union industry that has divided the industry into two distinct groups – diversified conglomerate credit unions and traditional credit unions that continue to embody credit unions' mission to serve people of modest means. Today, more than 100 credit unions surpass $1 billion in assets. These conglomerate credit unions are much larger than the typical community bank in their local market, which has an asset size of $103 million. The current tax-exempt status of these diversified conglomerate credit unions and lack of

equivalent regulation has created huge competitive inequities in the local marketplace and represents an ever-increasing abuse of the credit union tax subsidy.

This proposed legislation would exacerbate these competitive inequities, as well as raise safety and soundness concerns. Specifically, the bill would significantly increase credit unions' business lending authority, despite the fact that Congress specifically recognized credit unions' mission to serve consumers of modest means by clearly limiting credit unions' business lending in the Credit Union Membership Access Act of 1998 (CUMAA). CUMAA imposed the current limit of 1.75 times net worth not to exceed 12.25 percent of total assets. Also, CUMAA required credit unions to hold a higher leverage ratio than banks because (1) credit unions can build capital only through retained earnings; and (2) credit unions hold "investments" in their insurance fund equal to one percent of insured deposit and in their corporate credit union system, which are claims on a credit union's capital – thus overstating the amount of capital available to absorb unexpected losses. Lowering the net worth (leverage) ratio for credit unions, as the bill contemplates, while instituting a system of risk-based capital for all credit unions would artificially inflate the capital cushion purported to be available and ***still fall short of bank standards.***

In sum, the credit union lobby's efforts to obtain such expanded authority primarily benefits large credit unions. It is harmful to small credit unions that observe the intent of the law and is harmful to tax-paying community banks and savings associations. For these reasons, we re-affirm our opposition to any efforts to expand credit unions' lending authority.

(c) Prohibit Mixing of Banking and Commerce

ABA strongly supports legislative language to restrict new commercially-owned industrial loan corporations (ILCs) from engaging in expanded banking and branching powers. Specifically, ABA supports provisions in the regulatory relief bill that is now pending before the committee that would deny new commercially-owned ILCs de novo branching authority. The ILC de novo provision passed the House in the last Congress, but was not ultimately enacted.

We understand these issues are receiving renewed attention due to Wal-Mart's recent application for an ILC charter and federal deposit insurance. ABA has long taken the position that commercial firms should not own banks or savings institutions because of the potential for conflicts of interest (particularly in the credit granting process) and because of the potential for an unhealthy concentration of economic power. The so-called unitary thrift holding company charter, which allowed commercial firms to own a savings association, was closed prospectively in GLBA, precluding the possibility that commercial firms could use this channel to obtain a banking charter. The GLBA provision represented a consistent extension of congressional policy going back 50 years.

However, the ILC charter remains an open avenue for commercial firms – even those large firms that are not primarily financial in nature – to provide retail and corporate banking services. ABA strongly supports closing this loophole for commercial firms. We look forward to working with this committee on this important issue going forward.

Conclusion

In conclusion, the cost of unnecessary paperwork and red tape is a serious long-term problem that will continue to erode the ability of banks to serve our customers and support the economic growth of our communities. We thank you for continuing to look for ways to reduce the regulatory burden on banks and thrifts, and to restore balance to the regulatory process. Mr. Chairman, the ABA is committed to working with you and the members of this Subcommittee to achieve this goal.

Appendix

Additional Recommended Changes in Regulation

Not only are the demands on banks enormous, but they seem to change daily, which is its own form of burden. In addition to the specific reform delineated in the main body of this testimony, there are many other areas that should be addressed. Below is a summary of some recommended areas for reform. ABA is pleased to offer more detailed information to the Subcommittee upon request on any of these points:

a. Bank Secrecy Act (BSA)/Anti-Money Laundering

- **Eliminate Identity Verification for Monetary Instruments Conducted by Customers**

  In view of the passage of the USA PATRIOT Act and the regulations implementing section 326 requiring a Customer Identification Program ("CIP"), we recommend that the verification requirement of 31 CFR 103.29(a)(ii) be eliminated, since bank customers purchasing these instruments will have already been identified through their institution's CIP program.

- **Eliminate Notification to Directors or Designees of SARs**

  The federal banking agencies instruct a bank that "whenever [it] files a SAR ..., the management of the bank shall promptly notify its board of directors, or a

Subcommittee of the board of directors or executive officers designated by the board of directors to receive notice." (See, e.g., 12 C.F.R. 21.11 (h).) No such requirement exists in the Financial Crimes Enforcement Network's (FinCEN) parallel SAR regulation.

ABA believes that this expectation imposes a role on directors and executive officers (those who not serve as an institution's BSA officer) that is inconsistent with rational risk management responsibilities and compromises the board's independence in evaluating management performance under the board approved BSA compliance program. The requirement diverts scarce board and executive resources from more significant strategic and policy oversight functions. At the same time, it adds further risk to information security issues without any concomitant benefit to the bank. Mandating notification of SAR filing to the board or executive level for all institutions is an unwarranted imposition on, and deleterious to, sound corporate governance.

- **Establish Standard for Suspending SARs on Continuing Activity**

There are many reasons that banks file continuing SARs when the underlying customer transaction activity is not considered inconsistent with reasonable banking behavior. For example, many institutions file SARs out of a literal interpretation of the structuring guidance and in an abundance of caution, when they have no conviction that the customer is engaging in activity that constitutes money laundering.

Accordingly, ABA proposes that when an institution would otherwise file serial SARs on repeatedly similar customer activity, they should be permitted by a clear regulatory interpretation to suspend further SAR filing when: an original and two additional SARs report continuing similar activity by the same customer have been filed; law enforcement has not requested the continued reporting of the identified activity; and when no substantively different conduct alters the nature, significance or criminality of the repeated activity, or merits a SAR identifying the activity as a different type or involving perpetrators not previously identified.

- **Include FFIEC Exam Instruction to Invoke FinCEN Helpline**

ABA considers the FinCEN Helpline to be a valuable source of BSA interpretive guidance. Many bank representatives and agency examiners utilize this service to obtain staff analysis to assist in evaluating compliance issues. This option has helped many bankers and examiners resolve their disagreements about BSA regulatory applications arising during an exam. However, other examiners resist using this resource when their interpretations are challenged by management.

ABA proposes that the FFIEC agencies include in their uniform exam procedures the following mandatory instruction to expedite exam dispute resolution without requiring a banking agency to compromise its supervisory judgment: "Whenever management submits a written rebuttal to an examiner's BSA exception pertaining to 31 CFR Part 103 and includes therein a request to call the FinCEN Helpline, the examiner shall then call the FinCEN Helpline and, in the presence of

the institution BSA Officer, obtain a FinCEN staff advisory interpretation of the issue. If the advisory interpretation does not alter the examiner's judgment with respect to the exception, the FinCEN interpretation is to be recorded on the exception sheet along with any supplemental management position after the BSA Officer has heard the FinCEN interpretation."

- **Include FFIEC Exam Instruction on Conducting Transaction Analysis**

Despite agency requirements for a tailored risk-based BSA compliance program and mandatory testing of bank BSA controls, agencies request transaction files and conduct transaction analyses without finding fault with the bank's audit/testing of the same processes. This is not an appropriate use of resources by agencies and is unduly burdensome for banks.

The FFIEC should adopt the following uniform BSA exam instruction: "Examiners should not request a bank to assemble files or records for the purpose of conducting transaction testing, or engage in transaction testing, of any provision of a bank's BSA compliance program before evaluating the adequacy of the bank's audit or independent testing of the relevant program provision and concluding either (i) that the audit/independent testing is demonstrably not a reliable indicator of bank performance of the program provision being examined, or (ii) that deficiencies identified by bank audit or independent testing of the program provision have not been timely corrected."

b. Sarbanes-Oxley Implementation

- **Continued Oversight Critical**

ABA is appreciative that the Subcommittee held a hearing on Section 404 of the Sarbanes-Oxley Act, and we also appreciate SEC Chairman Donaldson's leadership in hosting an all-day roundtable discussion about ways to improve the process. These events helped identify the areas that are in dire need of attention, especially the need to streamline the process in order to reduce costs. Subsequently, the Public Company Accounting Oversight Board (PCAOB) issued further guidance intended to help clarify and streamline the process and the costs related to Section 404. It remains questionable as to whether the costs will, in fact, be reduced. We believe that this streamlining, including increasing the number of shareholders for registration purposes, can be done through regulatory processes with your support. Continued oversight is important to facilitate these changes.

c. Other Burden Reductions

- **Exemption for Small Depository Institutions from Some Auditing Requirements**

Consistent with our request, the FDIC has proposed rules to exempt depository institutions with $1 billion or less in assets from the management reporting requirement (and the audit and attestation of that report) and independent membership of the audit committee of the board of directors. Although the comment period has closed, these proposed rules have not yet been implemented.

Today, institutions of less than $1 billion represent only 14 percent of total industry assets. These requirements have imposed serious burdens on the smaller institutions that frequently result in duplication of these banks' internal audits and are not necessary to safe and sound operation of institutions of less than $1 billion.

The previous threshold, established by the FDIC in 1993, of $500 million is not appropriate today given the state of the industry. At the time the threshold was set, banks under $500 million represented 25 percent of total industry assets. The makeup of the industry has changed considerably since then. While more than 1,876 new banks have been chartered since then, today under-$500 million institutions represent only 9.7 percent of total industry assets. Moreover, in light of the structural changes which have taken place, the widely-held definition of a community bank today is one with assets as large as $1 billion or less.

- **Increase Shareholder Threshold for Registration**

To ameliorate the burdens associated with registration under the Securities Exchange Act of 1934, which the SEC set in 1964, for companies with 500 or more shareholders, ABA has proposed to the SEC increasing the triggering shareholder threshold to a number between 1,500 and 3,000. This level would appropriately establish a registration threshold comparable in effect to the level enacted in 1964 in terms of market presence. That is to say the market presence that 500 shareholders occupied in 1964 would require six times the dollar investment, or six times the number of shareholders to achieve the same presence in today's market. Recent activities by the SEC recognize that the cost of compliance with reporting

requirements is relatively greater for smaller companies than for larger issuers. Yet new requirements have significantly increased the costs to small companies.

The SEC regulations also provide that a company cannot seek to de-register until the number of shareholders of record is below 300. Sections 12(g)(4) and 15(d) of the Securities Exchange Act of 1934 should be similarly updated to place the threshold for de-registration within the range of 900 to 1,800 *shareholders of record.*

d. Eliminate Cross-Marketing Restrictions

ABA supports elimination of the prohibition in the Gramm-Leach-Bliley Act on cross-marketing between banks and non-financial portfolio companies where the Financial Holding Company (FHC) that owns the bank also has an investment position in a non-financial portfolio company made through its securities affiliate. No such prohibition exists when the investment position in a portfolio company is made through an FHC's insurance affiliate.

e. Problems in the Consumer Protections on Bank Sales of Insurance Law

Section 47 of the Federal Deposit Insurance Act establishes certain protections for consumers who purchase insurance products from depository institutions. These protections include a disclosure that insurance products are not backed by the Federal Deposit Insurance Corporation, that such products may involve an investment risk, and that the purchase of an insurance product cannot be conditioned upon the approval of a loan. This disclosure is

intended to distinguish insurance products from other banking products, especially insured deposit products.

Section 47, however, does not define the term "insurance product." As a result, the statute has been interpreted to apply to all types of insurance products, even insurance products for which the disclosure either is not necessary or is potentially confusing to the consumer. To address this problem, we recommend modifying the scope of the disclosure requirement to only apply to products wherein there is an investment risk, e.g., not fixed rate annuities or credit insurance.

f. Control of Shares by Trusts

We propose a safe harbor from the attribution rules of Section 2(g) (2) of the Bank Holding Company Act: (1) for shares held in trust through a regulated employee benefit plan; or (2) for mutual fund shares held in trust provided any investment adviser or affiliate with the power to vote 25 percent of the shares of the investment company transfers the vote to the beneficial owners or an independent entity; or (3) for shares held in a common or collective fund.

The purpose of this safe harbor is to exempt certain bank and bank holding company employee investment holdings from being improperly attributed to the bank holding company when those holdings are held through an employee benefit plan or a common or collective fund, or the employee assets are invested in mutual fund shares held in trust.

Without this exemption, bank holding companies, by virtue of their employees' activities, could be deemed to control the mutual fund or other company in which the plan or trust has invested.

g. Provide Parity for Savings Associations

ABA recommends eliminating disparate treatment of thrifts under the federal securities laws eliminating the investment adviser and broker-dealer registration requirements that apply to thrifts, but not banks, under the Investment Advisers Act (IAA) and the Securities Exchange Act of 1934.

Thrifts and banks provide investment adviser, trust and custody, third party brokerage, and other related services in the same manner, but have been subject to disparate requirements under the SEC's interpretation of the securities laws. There is no logical basis to structure the regulation of thrifts and banks differently. Removing the disparity will reduce regulatory burden by providing cost savings to affected thrift institutions and enhance competition that will benefit consumers.

h. Flood Insurance Compliance Problems

The Flood Disaster Protection Act of 1973 should be amended to streamline and simplify flood insurance requirements; resolve compliance problems when the official flood map is more than 10 years old; increase the "small loan" exception (currently $5,000) and allow adjustments for inflation on a regular basis; and to allow exceptions to flood insurance

requirements for agricultural real estate where the value of most of the collateral is represented by land, not permanent structures.

In addition, the forced-placement rules should be changed to allow lenders to force-place flood insurance within 30 days (instead of the current 45 days) of notifying the borrower and regulators should be given more flexibility to tailor their actions to individual cases by eliminating mandatory civil monetary penalties for certain pattern and practice violations of the National Flood Insurance Program.

i. Clarify Citizenship of National Banks & Federal Savings Associations

The National Bank Act generally provides that national banks are "citizens" of the states in which they are "located." However, the term "located" is not defined in statute, and the federal courts have not defined the term consistently. Since 1992, federal courts have disagreed about the meaning of "located," resulting in national banks having multiple state citizenships. Additionally, to avoid inconsistent treatment of federally chartered financial institutions under the diversity statute, we recommend a change in the Home Owners' Loan Act to consider that a federal savings and loan is a citizen in the state where its home office is located for federal court jurisdiction.

j. Establish Protections for Information Provided to Banking Agencies

ABA proposes amending the Federal Deposit Insurance Act to provide that when a depository institution submits information to a bank regulator as part of the supervisory

process, the depository institution has not waived any privilege it may claim with respect to that information. Recent court decisions have created ambiguity about the privileged status of information provided to supervisors when outside of the narrow confines of the actual examination. However, the purpose of providing confidentiality for examiner information is to encourage open communication between the regulator and the regulated financial institution. The process of preserving safety and soundness applies just as clearly to additional information supplied to regulators in any part of the supervisory process. The bank agencies have supported the change and we urge Congress to adopt these important protections for bank customers.